S. HRG. 100-262

THE EFFECTS OF AIRLINE DEREGULATION ON AIRLINE SERVICE TO SMALL- AND MEDIUM-SIZED COMMUNITIES AND SMALL BUSINESSES

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMPETITION AND ANTITRUST ENFORCEMENT

OF THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

THE EFFECTS OF AIRLINE DEREGULATION ON AIRLINE SERVICE TO SMALL- AND MEDIUM-SIZED COMMUNITIES AND SMALL BUSINESSES

CEDAR FALLS, IA—JUNE 1, 1987

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THE EFFECTS OF AIRLINE DEREGULATION ON AIRLINE SERVICE TO SMALL- AND MEDIUM-SIZED COMMUNITIES AND SMALL BUSINESSES

MONDAY, JUNE 1, 1987

U.S. SENATE,
SUBCOMMITTEE ON COMPETITION
AND ANTITRUST ENFORCEMENT,
COMMITTEE ON SMALL BUSINESS,
Cedar Falls, IA.

The Subcommittee met, pursuant to notice, at 10 a.m., in the Board Room of Gilchrest Hall, University of Northern Iowa, Hon. Tom Harkin, presiding.

STATEMENT OF HON. TOM HARKIN, A U.S. SENATOR FROM THE STATE OF IOWA

Senator HARKIN. Good morning. The Subcommittee on Competition and Antitrust Enforcement of the Senate Small Business Committee will come to order. I'm Senator Tom Harkin from Iowa. I am on the Senate Small Business Committee where I have been since I came to the Senate, and this year assume the chairmanship of the Subcommittee on Competition and Antitrust Enforcement.

In Iowa and in many States of the Midwest we are replete with small businesses. And we are concerned that, of course, these small businesses are able to continue to compete in a competitive environment, in a truly competitive and open market environment. And to that end, we have been taking a look, a long hard look at the status of airline deregulation and what it means to the small towns and communities, not only in Iowa, but throughout our Country.

Originally these hearings were set up to focus on one specific problem as sort of indicative of a problem that we are encountering all over the Country. It had to do with airline service to O'Hare Airport from Waterloo and Dubuque. We will be talking about that, but I want to also keep it in the context of the overall picture of what's happening around the Country. Commercial air travel has become crucial. Without it many types of commerce simply can't be carried out. The business community needs air service, just as they need electricity, as they need mail.

Since the deregulation of airline service about a decade ago, there has been a considerable deterioration of service in smaller cities. The loss of service has affected the ability of many business-

es in these communities to operate smoothly, placing those businesses, I believe, at a serious disadvantage when compared to their competitors in larger cities.

The cities themselves have experienced a reduced ability to attract certain types of new businesses, or conventions, for example, as a result of the loss of air service. The cities of Dubuque and Waterloo were recently notified that they would be losing their service to O'Hare Airport.

Under the essential service regulations, Dubuque and Waterloo are entitled to service to Chicago. But some U.S. DOT officials indicated that service to Chicago meant either O'Hare or Midway. However, I think local officials and business leaders with whom I have spoken know that service to Midway would be very damaging to their communities and their businesses because of the reduced access to other markets beyond Midway Airport.

Fortunately, it now appears that a solution to that particular problem is at hand, at least for the short term, anyway. And I do want to say that I appreciate the work that the U.S. DOT, including those witnesses who will be here today, put into that effort. But that does not change, as I said in my opening remarks, the need to examine the general structure to see if there is sufficient protection for the future, for these cities and for other medium-sized cities.

I just want to have some questions this morning about—considering the following: To what extent are these problems the result of straight forward economic and geographic reality? That is, an open marketplace. To what extent are they the result of the use of market power by large carriers which either control a marketplace or find it convenient to set rates at high levels that match other carriers in that same marketplace? Why is it that the cheapest unrestricted one-way fare from Des Moines to O'Hare was $220 in May, but the cheapest unrestricted fare to Washington, D.C., was actually $15 less, or the cheapest unrestricted fare between Des Moines and New York was only $9 more?

That does not seem to me to be the result of marketplace or demographic realities at work. To what extent do policies of the Federal Government impact the service that we receive? Clearly, we need to maintain the safety of the system. That's our first priority in the Federal Government. But the number of air traffic controllers, the type of computer equipment, the number of auxiliary runways, landing systems, and so forth, are also important questions which affect the capacity of the system.

The recent decision by U.S. DOT to allocate slots to the airlines has also limited the flexibility of the Department to assure needed service to medium-sized cities. Some of these questions come down to money. But I think we will have testimony today indicating that there is some money in the airway and airport trust fund, something over 5 billion dollars, if my memory serves me right. And the question again is one of are we going to spend that money to upgrade the system?

Last, the Essential Air Service system seems to be of great importance. It provides a subsidy which allows service to cities like Clinton and Ottumwa in Iowa to continue. But it also provides rights of access for cities like Waterloo and Dubuque so they can

maintain a minimum level of service. That can be assuring to a business thinking of locating in a smaller city. But the administration is suggesting that Essential Air Service systems should be abandoned, and I would like to know why.

Well, these are the questions I have. I just feel that the long term business health in Iowa and across the Country will be dependent on what kind of an infrastructure we have providing businesses to flourish and to provide adequate air travel in and out of these communities.

That ends my opening statement. I have a statement from Senator Carl Levin from Michigan, who is also on the Subcommittee. Without objection, I will make his statement a part of the record. He also asks that the hearing record be left open for some further remarks and testimony that he is obtaining from the State of Michigan. Without objection, the record will be left open for that.

[The prepared statement of Senators Harkin, Levin, and Wallop follow:]

OPENING REMARKS

SENATOR TOM HARKIN
CHAIRMAN
SUBCOMMITTEE ON COMPETITION AND ANTITRUST ENFORCEMENT
SENATE SMALL BUSINESS COMMITTEE

June 1, 1987
Cedar Falls, Iowa

Commercial air travel has become crucial. Without it, many types of commerce simply cannot be carried out. The business community needs air service just as they need electricity and the mail.

Since the deregulation of airline service about a decade ago, there has been a considerable deterioration of service in smaller cities. The loss of service has affected the ability of many businesses in smaller cities to smoothly operate, placing those businesses at a serious disadvantage compared to their competitors in larger cities. And cities themselves have experienced a reduced ability to attract certain types of new businesses as a result of the loss of air service.

The cities of Dubuque and Waterloo recently were notified that they would be losing their service to Chicago's O'Hare Airport. Under the Essential Air Service regulations, Dubuque and Waterloo are entitled to service to Chicago. But some U.S. Department of Transportation officials indicated that "service to Chicago" meant either O'Hare or Midway. However, local officials and business leaders know that service only to Midway would be very damaging to their communities and to their businesses individually because of the reduced access to other markets.

Fortunately, it now appears that a solution to that particular problem is at hand. I appreciate the work that the U.S. Department of Transportation, including those witnesses who will be here today, put into that effort. But, that does not change the need to examine the general structure of the airline system to see if there is sufficient protection for the future for these cities and for other medium sized cities.

Since deregulation, the business traveler who is not traveling to or from a major "hub" city, can expect to experience problems in terms of both price and simple availability of service.

To what extent are those problems the result of straightforward economic and geographic realities, that, is an open marketplace?

To what extent are they the result of the use of market power by large carriers which either control a marketplace or find it convenient to set rates at a high level that matches the other carrier in the marketplace?

Why is it that the cheapest, unrestricted one-way fare from Des Moines to O'Hare was $220 in May. But, the cheapest unrestricted one way fare between Des Moines and New York was only $9 more. To Washington D.C., it was actually $15 less. At first glance, that does not seem to be the result of an open marketplace or demographic realities at work.

To what extent do policies of the federal government impact the service that we receive? Clearly, we have a need to maintain the safety of the system. That is the first priority. But, the number of air traffic controllers, the type of computer equipment, the number of auxiliary runways, for instance, are also important questions which affect the capacity of the system. The recent decision by the U.S. DOT to allocate slots to the airlines have also limited the flexibility of the Department to assure needed service to medium sized cities.

Some of those questions come down to money. And, we have lots of money paid by air travelers into a trust fund that are not being spent. But others come down to the question of priorities.

The Essential Air Service system seems to be of great importance. It provides a subsidy which allows service to cities like Clinton and Ottumwa to continue. But, it also provides rights of access for cities like Waterloo and Dubuque so they can maintain a minimal level of service. That can be assuring to a business thinking of locating in a smaller city. But, the Administration is suggesting that the Essential Air Service system should be abandoned. Why?

I hope that we will be able to obtain answers to some of these questions at this hearing today, and to gain a better understanding of the problems plaguing communities, businesses, travelers and the airlines themselves.

I believe that the long term health of Iowa and other areas across the country is dependent on providing a sufficient infrastructure to allow business to flourish. Infrastructure is like the soil, without it, we cannot have growth. Airports and air service is a part of that infrastructure just like our highways and sewers. We must not allow it to deteriorate. If we do, the economic health of medium sized cities and the areas around them is sure to eventually deteriorate as well.

Statement of Senator Carl Levin
Senate Commitee on Small Business,
Subcommittee on Competition and Antitrust Enforcement
Hearing on the effects of airline deregulation on
airline service to small and medium-size communities
June 1, 1987

I commend the Subcommitee Chairman, Senator Harkin for holding this hearing on the effects of airline deregulation. This is an issue of critical importance to our country's small and medium-size communities, many of whom badly need dependable air service.

Over the past few months, I have been hearing from my constituents about the impact deregulation is having on small communities and small businesses in Michigan, and particularly in the Upper Peninsula. I have asked some of those who contacted me to submit written testimony for this hearing. I have also asked the Michigan Aeronautics Commission to submit a short statement describing the impact of deregulation on air travel in my state, with particular reference to the effects on small business. In order that this testimony, as well as further remarks that I might have on the subject, may be included in the hearing record, I would ask the Chairman to leave the hearing record open until such time as the testimony is ready to be submitted.

ECONOMIC DEVELOPMENT AND SCHEDULED AIR SERVICE

Easy and convenient access to the national transportation system is one of the most important prerequisites for economic growth and development. For small communities in isolated locations, like in Michigan's Upper Peninsula or in northern lower Michigan, this translates into dependable scheduled air service.

Time and again, business leaders have stated that the availability, or lack of dependable air service, is a determining factor in decisions to move into a new location, expand an existing facility or relocate.

Congress recognized the importance of scheduled air service to small and isolated communities when it added Section 419 "Small Community Air Service, Guaranteed Essential Air Transportation" to the Airline Deregulation Act of 1978. Section 419 is scheduled to expire in October of 1988. The DOT states that 68 of 97 subsidized points, excluding points in Alaska, will lose air service if the Essential Air Service (EAS) program ends.

Growing national concern over the serious economic impact of the loss of air service at small communities has resulted in the introduction of several bills in Congress for the adoption of a new, revised EAS program to provide new opportunities for development of the air service markets at small communities. The most significant bills are S.582, introduced by Senator Exon (D-Neb.), H.R. 2217, introduced by Rep. Oberstar (D-Minn.), and H.R. 2318, by Rep. Hammerschmidt (R-Ark.).

The Michigan Aeronautics Commission, deeply concerned about the future of schedule air service at the small communities in the State, adopted the following recommendation at its regular meeting of May 13 in Escanaba.

The Michigan Aeronautics Commission believes that scheduled air service is vital for the economic development of small communities in isolated locations, for the attraction of new businesses, and for the growth and development of the tourist industry.

In adopting the Airline Deregulation Act of 1978, Congress recognized the importance of scheduled air service to small communities by including the essential air service provisions.

The current law has not been able to fulfill the intent of Congress for the development of the small community markets, because it contains no incentives for air carriers or communities and provides for little local participation.

Any new Essential Air Service legislation should contain the following provisions:

1. A clear definition of what constitutes essential air service with regard to aircraft size, frequency, scheduling, fares, seat requirements, etc. On linear routes, seats quite often were pre-empted down-line, thus the guaranteed number was not actually available at all points.

2. Increased participation by states and communities in establishing these criteria for each EAS point.

3. Incentives for EAS carriers and communities to develop the markets and to improve service quality.

4. Closer monitoring of service quality and carrier performance. This could be delegated to the states and/or communities.

5. Penalty provisions for violations of the standards established by the law on subsidized routes.

6. Stricter criteria for the designation of EAS points, like market size, distance to other air carrier airports, etc.

7. A provision for the designation of new EAS points, upon recommendation by the State, and a stated willingness of state/local participation in pilot project funding.

8. Any community designated an EAS point should have the option to withdraw from the program.

The Michigan Aeronautics Commission supports new, improved essential air service legislation which meets these objectives.

Director

HB:MF:869:7(all)
(06/01/87)

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June 8, 1987

PLEASE REFER TO OUR FILE NO.
10337.37

Senator Carl Levin
459 Russell Building
Washington, D.C. 20510

Re: "You Can't Get There From Here"

Dear Senator Levin:

The caption of my letter, I believe, adequately defines the status of air service for many rural communities in Upper Michigan.

I have been a very active member in Governor Blanchard's Air Service Task Force for the State of Michigan.

I have also been very active in Delta County in attempting to get additional air service to Delta County.

I have, over the past year, spent thousands of hours attempting to find an additional air carrier to Delta County. I have had contacts with U.S. Air, Piedmont, Northwest, Air Wisconsin, Midstates, Fischer Brothers, and Simmons Airlines. This letter is an attempt to present to yourself and other members of the United States Senate the dire straits which exist in rural communities for air service.

Current Situation

Currently, Delta County is served by one air carrier, American Eagle, which provides service to Green Bay, Wisconsin, and Chicago, Illinois. There are two flights per day. Delta County, which is part of the State of Michigan, has no air service to its Capital in Lansing, Michigan, or to any other downstate community. In order to get to the Lower Peninsula of Michigan, we must fly through two other states, that being Wisconsin and Illinois, before coming back to Michigan. Needless to say, that flight is neither time

efficient or economic. The cost to fly to Lower Michigan, at last check, was $440 and it took me approximately six and one half hours to fly from Escanaba to Lansing.

Effect of Code Sharing Arrangements

With the major air carriers having code sharing arrangements with commuter lines, an effective monopoly exists in small communities. This monopoly is created because no other commuter or small short-line carrier can deliver or compete with a major carrier who supports with manpower and financially their code sharing partners. The net effect to the code sharing arrangement has been monopoly creation in small markets and competition for the larger "hub" cities. Currently, in the Upper Peninsula of Michigan, Simmons Airlines shares two code arrangements with (1) Northwest, and (2) American Airlines. The result of one carrier having two code sharing arrangements effectively precludes competition in the Upper Peninsula marketplace. Simmons Airlines is allowed to select which community it will establish service in, with the consent of its code sharing partner. Obviously, there is no incentive in the Upper Peninsula for Simmons to provide both Northwest and American service in many communities, for it competes with itself.

Not having a code sharing partner effectively determines that one will not compete in the marketplace because of the computer reservation requirements. In preparation for this letter, I attempted to find from our local travel agencies, any non-affiliated commuter lines. We could not, in our northern region, find any non-affiliated commuter airlines. The inability to code-share effectively eliminates any non-affiliated regional commuter line competing with a code-sharing commuter. With the advent of the current merger "mania", there are less and less major airlines to have commuter code sharing arrangements with. Hence, further monopolization of the marketplace in the rural communities.

Hub Cities

The creation of "Hub Cities" being dominated by one carrier also serves to reduce competition. For example, prior to Fischer losing its "Airlink" designation, I attempted to get Fischer Brothers to fly from Escanaba to Detroit. Fischer was "given" Escanaba by Northwest and was prepared to fly from Escanaba to Detroit, but then lost their "Airlink" designation.

I then contacted Northwest and was asked who was the designated airline for Escanaba. They informed me that Simmons did not want to serve Escanaba and anyway Detroit was now "full". The "no room at the inn" philosophy effectively denies Escanaba access to another hub and competitive service. I do know another "airline" would look to service our area if Northwest allowed it and access to Detroit was given..

Look at what their mergers have created for the upper midwest. Northwest controls the following "hub and mini-hubs" in the Midwest: Detroit, Milwaukee and Minneapolis. Piedmont controls Dayton and Delta, Cincinnati. The ability to offer service in a given community is directly affected by who controls a given "hub". Without cooperation from Northwest or its code-partner, expanded service is not possible in rural Upper Michigan communities.

Status of Airline Service Since Deregulation

The Delta County community has gone from jet service with four flights per day to turbo prop 36-seat service (currently, although expected to decline) in 1987. Not only the quantity of air service has deteriorated, but likewise the quality of the air service. Many of the same complaints of major carriers were first echoed by the rural community as it relates to their current air service. (Lost bags, delays, etc.)

Currently, Delta County has 90% to 95% of its ticketed passengers now flying out of some other community. This in and of itself has a significant economic impact upon Delta County.

Impact Upon Economic Development of Rural Areas

My legal practice is approximately 90% devoted to economic development. The inability to have quality air service, with frequent flights, and lost competitive service, is the single most detrimental impact upon economic development in our and other rural communities. In fact, I can point out several instances where businesses which I have done expansion projects for in prior years, are doing economic development expansion in other communities closer to metropolitan areas because of air service. Those businesses are satisfied with the productivity of their labor force, the cost competitiveness of their product, except, they cannot get

to the customers and the customers cannot get to them because of the air service.

If we cannot keep existing businesses in our communities because of air service, how can we expect to ever lure new businesses into our community with the problems existing in air service.

The Delta County community is aggressively looking at tourism as a major source of economic development in the years ahead. The inability to have adequate air service severely impacts communities and their ability to get seminars, conferences, and conventions. Traverse City, Michigan, which has expended substantial sums and has outstanding convention facilities, is facing the problem of being unable to obtain conventions and facilities because of its inability to have adequate air service. Rural communities are now at the crisis stage. Further deteriorations in the quantity and quality of air service are clearly facing us unless protective measures are done to provide competition in the marketplace. This may mean breaking up the code-sharing relationships of commuter lines with the major carrier.

Cost

No discussion of the effect of air service upon economic development could be addressed without at least some small mention of the cost of flying. It is somewhat unbelievable to understand why it costs one-third the amount of money to go from Chicago to Los Angeles than it does Escanaba to Lansing, Michigan, its State Capital. Major corporations in Escanaba are paying in excess of $500 to go from Escanaba to Ohio. That costs more than it does to fly to London from Chicago.

Conclusion

Deregulation, although beneficial to many of the "hub" communities, has been an economic disaster for the rural communities. Congress must address the devastating effect of deregulation on rural communities. I would be prepared to provide any further information which I have concerning this impact, should you so desire.

Sincerely yours,

BUTCH, QUINN, ROSEMURGY,
JARDIS & VALKANOFF, P.C.

Dennis C. Valkanoff
Attorney at Law

DCV/drh

STATEMENT BY SENATOR MALCOLM WALLOP
SENATE SMALL BUSINESS SUBCOMMITTEE
ON COMPETITION AND ANTITRUST ENFORCEMENT
JUNE 1, 1987

I'M PLEASED TO SEE THE SMALL BUSINESS ANTITRUST SUBCOMMITTEE EXAMINING THE ISSUE OF THE EFFECT OF AIRLINE DEREGULATION ON SMALL COMMUNITIES AND SMALL BUSINESSES, ESPECIALLY IN LIGHT OF THE EXPIRATION OF THE ESSENTIAL AIR SERVICE PROGRAM NEXT YEAR.

MY HOME STATE OF WYOMING POSES A REAL CHALLENGE FOR BOTH THE AIR TRAVELER AND FOR THE AIRLINES. A SMALL POPULATION (JUST OVER 500,000) IS SPREAD OVER A LARGE LAND AREA. WE RANK 50TH IN POPULATION BUT 9TH IN TOTAL SQUARE MILES. AIR SERVICE CAN BE FOUND IN JUST 9 CITIES, AND ONLY TWO OF THOSE, CASPER AND CHEYENNE, HAVE OVER 50,000 RESIDENTS. ALL BUT ONE, CASPER, ARE ESSENTIAL AIR SERVICE COMMUNITIES. AIR TRANSPORTATION HAS BECOME CRITICAL TO THOSE TOWNS IN LIGHT OF STEADILY DECLINING BUS SERVICE AND THE PULLOUT OF AMTRAK IN 1983, LEAVING THE STATE WITH NO PASSENGER RAIL SERVICE.

I SUPPORTED THE PASSAGE OF AIRLINE DEREGULATION BACK IN 1978 AND BELIEVE ITS EFFECT HAS BEEN A POSITIVE ONE FOR THE AIR TRAVELER. HOWEVER, DEREGULATION HAS PRODUCED SOMEWHAT MIXED RESULTS FOR MY STATE. FOR EXAMPLE, THE COMMUNITY OF WORLAND, LOCATED IN NORTH CENTRAL WYOMING, IS VERY DEPENDENT ON AIRLINE SERVICE AS IT IS THE ONLY EFFICIENT MEANS OF TRAVEL IN AND OUT OF THE AREA. YET, HIGH AIR FARE ($120 EACH WAY TO DENVER) AND THE LIMITED NUMBER OF FLIGHTS (2 EACH DAY WITH INTERMEDIATE STOPS IN LARAMIE AND LANDER) PUT WORLAND AT A REAL COMPETITIVE DISADVANTAGE WITH CASPER, WHICH IS ABOUT A 165 MILE DRIVE, AND BILLINGS, A 160 MILE DRIVE. CONTINUED AIR SERVICE IS CRITICAL AT WORLAND BUT MANY TRAVELERS WOULD RATHER DRIVE TO THESE OTHER COMMUNITIES FOR BETTER CONNECTIONS AND FARES. IN ADDITION, WORLAND MAY SOON BE SEEING A CHANGE IN SERVICE WITH MESA AIRLINES' PROPOSED ACQUISITION OF CENTENNIAL, THE CURRENT CARRIER. THIS IS NOT AN UNUSUAL CIRCUMSTANCE IN WYOMING SINCE SOME 10 AIRLINES HAVE STARTED UP AND THEN PULLED OUT OVER THE PAST 8 YEARS. IN FACT, WORLAND'S EXPERIENCE EASILY TYPIFIES THAT FACED BY MOST OF THE STATE'S AIRPORT COMMUNITIES AND THE SMALL BUSINESSMEN, TOURISTS (WHO PROVIDE A GREAT DEAL OF REVENUE TO SMALL BUSINESSES) AND OTHERS ATTEMPTING TO TRAVEL TO WYOMING'S CITIES.

A DIFFERENT SITUATION EXISTS IN CHEYENNE, THE CAPITAL OF THE STATE. ALTHOUGH AIR PASSENGER TRAVEL DECLINED SIGNIFICANTLY FOR SEVERAL YEARS AFTER DEREGULATION, THE NUMBERS ARE BEGINNING TO SLOWLY INCREASE AND THE CITY HAS EMBARKED ON A CAMPAIGN TO IMPROVE AIR SERVICE BY ENCOURAGING A MAJOR CARRIER TO COME TO CHEYENNE. AIRPORT MANAGERS HOPE TO WOO EITHER DELTA OR TWA TO THE AREA, CITING THE CITY'S STATUS AS THE CAPITAL, A MAJOR BUSINESS CENTER, AND AS AN EXCELLENT POTENTIAL ALTERNATIVE HUB TO DENVER, THE WEST'S BUSIEST AIRPORT. CHEYENNE HAS ALREADY MADE A PRESENTATION TO TWA AND IS EXPECTING TO HEAR FROM THAT AIRLINE BY LATE SUMMER. I ALSO MIGHT NOTE THAT CHEYENNE HOPES TO INCREASE ITS IN-STATE ROUTES, SOMETHING ALMOST UNHEARD OF IN WYOMING SINCE THE 1960s, WITH FLIGHTS TO ROCK SPRINGS AND GILLETTE.

CLEARLY, THE WYOMING EXPERIENCE POINTS TO THE CONTINUED NEED FOR DEPENDABLE AIR SERVICE FOR OUR NATION'S SMALL COMMUNITIES. IN SOME CASES, THIS WILL MEAN ENSURING THE CONTINUATION OF ESSENTIAL AIR SERVICE. IN OTHER CASES, IT WILL MEAN INCREASED SELF-RELIANCE ON THE PART OF THE CITIES, PERHAPS BY FOLLOWING CHEYENNE'S LEAD TO AGGRESSIVELY COURT THE AIRLINES IN ORDER TO ENSURE BETTER, MORE COMPETITIVE AIRLINE SERVICE FOR THEIR RESIDENTS AND BUSINESSMEN. WHATEVER THE CASE, NEARLY ALL WYOMING BUSINESSES -- FROM AGRICULTURE AND ENERGY INTERESTS TO MOTEL OWNERS AND RESTAURANTS -- RELY ON AIR SERVICE IN SOME FASHION. THE CONTINUATION OF RELIABLE AIR SERVICE IS IMPERATIVE FOR OUR STATE.

I WOULD LIKE TO REQUEST THAT A LETTER FROM JOSEPH NEHL, WORLAND AIRPORT MANAGER, BE ENTERED INTO THE HEARING RECORD.

WORLAND MUNICIPAL AIRPORT
P.O. Box 606
1438 Airport Road
WORLAND, WYOMNG 82401

May 27, 1987

Senator Malcom Wallop
452 Russell Building
Washington, D.C. 20510

Dear Senator Wallop;

I thank you for your inquiry of airline deregulation's effect on the City of Worland Wyoming.

As you know the EAS subsidy program guaranteed Worland with two round trips to Denver six days per week. This guarantee has sheltered Worland from deregulation's effect to a certain extent.

Within the last eight years we have had three air carriers serve Worland with subsidy. Frontier, AirUS and currently Centennial. Centennial is now being bought by a New Mexico firm called Mesa Airlines. Rumor has it that Mesa is contemplating a merger. Where that leaves Worland is anyones guess.

Along with Worland Centennial serves Cody, Riverton, Lander, Rock Springs, Laramie and Jackson during the tourist and ski season. Frontier and AirUS also served Cody, Riverton/Lander and Laramie. The subsidy that is earmarked for Worland buffered these communities from having interruptions in air service or none at all.

There has been around ten different airline operations start-up and fold in Wyoming within the last eight years. Centennial being the latest, and as previously mentioned they are changing hands at the present time.

For this portion of Wyoming to have a continuous, year around air service we need to have the EAS Subsidy program. Compared to other subsidized forms of transportation this is the program to continue with for the maximum benefit of all.

Until the major airlines establish their routes we need help to ensure continuous year around air service to foster a self sustaining business environment in the State of Wyoming.

Sincerely,

Joseph M. Nehl, Airport Manager

Senator HARKIN. So again, I welcome you all here today. We have about two-and-a-half hours, or something like that, and we are going to take between 45 minutes and an hour per panel. Our first panel consists of Mr. Paul Frommelt, chief executive officer of Frommelt Industries, Dubuque, IA; Mr. Don Tamisiea, vice president of personnel for Viking Pump, Cedar Falls, IA; Mr. David Maahs, assistant vice president of budget and economic development of the Greater Des Moines Chamber of Commerce; and Miss Ellen Lau, president of Travel Headquarters, Dubuque, IA.

We welcome you all to the Subcommittee. I have read some of your testimonies that I have had before, and I appreciate that. What we will do is if we could just start with Mr. Frommelt, and we will just work down the panel. And if you could, just sort of summarize, and let me think—oh, less than 10 minutes each, maybe? Just sort of summarize your testimony and hit the highlights of it. Then we can have a question-and-answer period and an open discussion.

Mr. Frommelt, thank you very much for coming to the Subcommittee. I appreciate your being here, and without objection your statement will be made a part of the record in its entirety, and I just ask you to go ahead and proceed as you so desire.

STATEMENT OF PAUL FROMMELT, CHIEF EXECUTIVE OFFICER, FROMMELT INDUSTRIES, DUBUQUE, IA

Mr. FROMMELT. Thank you, Senator. As you stated, my name is Paul Frommelt, and I'm the chief executive officer of Frommelt Industries. I was in Boston this week and I was asked to supply 70 copies of my statement for this meeting and——

Senator HARKIN. I hope you didn't comply with that.

Mr. FROMMELT. Well, I didn't because the air service was so poor I didn't have time to get it back. That's just a Government formality, Senator, probably. Anyway, I have a plant in Dubuque of about 230,000 square feet. I employ 300 people. I have 15 people that travel continually. We have been in our plant 3 years. Before 1984 we had seven plants scattered throughout Dubuque. We had a choice at that time of either consolidating into one plant in Dubuque or consolidating into one plant somewhere else. We desired to stay in Dubuque. We are Dubuque people. Our family is Dubuque. We feel the class of people, the employees that we have, are the finest in the Country.

I fail to state that we also manufacture in three foreign countries. We manufacture in Kobe, Japan; in Toronto, Canada; and Kootstertille, Holland. So we had a choice of consolidating these plants either in Dubuque or outside Dubuque, and we chose to stay in Dubuque. It happened that that year I was the president of the Chamber of Commerce, also, and I only state that for the reasons of talking about Dubuque expansion, talking about expansion for my own company.

Well, as I stated, we decided to stay in Dubuque. We decided to stay in Dubuque for the reasons stated before and also figuring, very centrally located, that I could have my people traveling all over the Country and getting in and out in a very reasonable amount of time, very economically. Well, it started out that way.

As you well know, the service to Dubuque has declined and diminished, which is a great blow to—not only to Frommelt Industries, but to the economy of Dubuque.

We have 46 representatives throughout the Country, and with the 46 representatives, they employ about 300 sales people. We bring those sales people into Dubuque on a continuing basis week in and week out for training, and it's a continual hassle. As air service has diminished, we have a great problem in bringing these people into Dubuque. The principals of each one of these companies state that for the cost, for the time it takes, you are going to figure you are going to waste 1 day in and 1 day out. This is very detrimental to their keeping people out in the field and selling. This diminishes, again, their return.

We have people calling on Dubuque, calling on us. As stated to me on numerous occasions by our purchasing people, it has cut down our competitive base. Because when you try to find, to buy through catalogs and things, you do not have the same competitive advantage that you have when you can sit down with a vendor and discuss your many options in purchasing.

We are in the process now, or have been in the process in the past 6 months, of talking about expansion again. We would like to add on to the 230,000 square foot building. I guess I also failed to state that we have a payroll of between $5 and $6 million a year. So we have a lot of people that depend on Frommelt to expand and to grow, take care of their families. Well, we have got to take a long hard look right now at how much expansion we are going to do, if we are going to do expansion in Dubuque. We are continually bombarded from other States to come there, to see what they have, to see how cheap land is, to see how fast they can get us in and out. We want to stay where we are. We would like to stay in Dubuque.

But with the air service that we've had and the not bright outlook as to finalized air service with slots in Dubuque, we have to give that a second thought. And that's not a threat, it's simply a statement of fact. We need Dubuque, we need the airport in Dubuque, and we need it very badly. Thank you very much.

Senator HARKIN. Mr. Frommelt, thank you very much for your testimony. I think what we will do is just go right on down. We will just have each one, and then we will get into a general discussion. Does that make sense?

Mr. FROMMELT. Fine.

Senator HARKIN. Good. Mr. Tamisiea.

STATEMENT OF DON TAMISIEA, VICE PRESIDENT OF PERSONNEL, VIKING PUMP, CEDAR FALLS, IA

Mr. TAMISIEA. My name is Don Tamisiea. I'm vice president of personnel at Viking Pump, which is a subsidiary of Houdaille Industries, Inc. Viking Pump just completed its 75th anniversary. The company was founded here in Cedar Falls in 1911. We are the largest manufacturer of rotary pumps in the world. We manufacture pumps with pumping capacity from a gallon a minute to over 1,100 gallons a minute.

We have over 700 employees, 650 of which are located here in Cedar Falls. In addition to our manufacturing facilities here, we

have a service center in St. Louis, a subsidiary of Shannon, Ireland, and recently we established a joint venture in Mexico. We have 21 field offices located throughout the United States, sales offices in Holland, Singapore, and Mexico City.

Our products are primarily sold through our 75 distributors domestically, and another 63 foreign distributors. 16 percent of our sales are exported. I think this information is significant in commenting on the subject of today's hearing, since an adequate, economical transportation system is extremely important to the future success of our company and to many of the other companies in our metropolitan area.

Prior to a year ago, we had the unfortunate distinction of being the largest standard metropolitan statistical area in the United States that was not connected to the interstate highway system.

Now we find ourselves in a somewhat similar situation as it relates to air transportation service in a time when our company, as well as many others in this area, are faced with severe competitive pressures, both domestically and internationally.

The air service in this area has continued to deteriorate in recent years. There has been a constant turmoil caused by frequent changes in carriers, as well as schedules that do not tie into connecting flights into Chicago and St. Louis. As a result, additional time and costs are incurred by employees, distributor personnel, and our existing and potential customers.

To put this into perspective, we have reviewed our travel records for the previous 12 months and determined that there were over 400 flights made by our personnel and distributor personnel in and out of Cedar Falls. This number does not include the many suppliers who call on us and other visitors.

To expand our business in a shrinking market due to many American firms that have been moving off shore, we have aggressively developed some new products which we have recently introduced, and others are on the drawing board. New product introduction is expensive and will require even more travel in the future. Thus, our concern for more adequate air service at a more reasonable cost.

Not only are the frequency of flights and their connections with major cities important, so is the cost. Recently the round trip cost to Chicago was $170. What it is today I don't know because it changes so frequently. By comparison, flights out of Cedar Rapids and Des Moines, to the East Coast and western cities, frequently run around $190. We've had instances when our employees have flown to Shannon, Ireland, for $670, and we pay the same amount to fly to Fort Lauderdale, which is our corporate headquarters.

I realize there are many factors that affect cost, one of which is certainly demand. We are in a dilemma. As the poor service and high costs continue, it is not only a negative impact on future economic development, but future development of existing firms in this area as well. As you may know, Black Hawk County ranked number 5 in the nation of counties losing population recently.

Another concern we have is the reduction in the quality of aircraft, smaller planes, as opposed to the DC-9 jet service. Without improvement and stability in air transportation in this area, our company, as well as many others, will continue to suffer economi-

cally and it will deter prospective newcomers from giving us a serious consideration. Without economic development, this area will continue to decline. I appreciate the opportunity to appear before you and hope that my comments will be helpful.

Senator HARKIN. Very much so. Thank you very much, Mr. Tamisiea.

[The prepared statement of Mr. Tamisiea follows:]

VIKING PUMP HOUDAILLE
ONE OF THE HOUDAILLE PUMP GROUP

Viking Pump-Houdaille, Inc., A Subsidiary of Houdaille Industries, Inc.
Cedar Falls, Iowa 50613 U.S.A. Telephone (319) 266-1741
Telex 465-632 Cable "Viking"

Statement before the Competition and Antitrust Enforcement Subcommittee of the Senate Committee on Small Business June 1, 1987 Cedar Falls, Iowa.

My name is Don Tamisiea. I'm Vice President of Personnel of Viking Pump - A Subsidiary of Houdaille Industries, Inc. Viking Pump just completed celebrating its 75th Anniversary. The Company was founded here in Cedar Falls in 1911.

Viking Pump is the largest manufacturer of Rotary Pumps in the world. We manufacture pumps with pumping capacity from one gallon a minute to over 1,100 gallons. We have over 700 employees, 650 of which are located in Cedar Falls.

In addition to our manufacturing facilities here, we have a Service Center in St. Louis, a Subsidiary in Shannon, Ireland, and a recently established joint venture in Mexico.

We have 21 Field Sales Offices located throughout the U.S. and Sales offices in Holland, Singapore and Mexico City.

Our products are primarily sold through our 75 domestic and 63 foreign distributors. Sixteen percent of our sales are exported.

I think this information is significant in commenting on the subject of today's hearing since an adequate, economical transportation system is extremely important to the future success of our company and the many other companies in our Metropolitan area. Prior to a year ago, we had the unfortunate distinction of being the largest Standard Metropolitan Statistical Area (SMSA) in the United States that was not connected to the Interstate Highway System.

Now we find ourselves in a somewhat similar situation as it relates to air transportation service in a time when our company, as well as many others in this area, are faced with severe competitive pressures both domestically and internationally.

The air service in this area has continued to deteriorate in recent years. There has been constant turmoil caused by frequent changes in carriers as well as schedules that do not tie into connecting flights in Chicago and St. Louis. As a result, additional time and costs are incurred by employee, distributor personnel and our existing and potential customers.

To put this into perspective, we reviewed our travel records for the previous twelve months and determined there were almost 400 flights made by our personnel or distributor personnel in and out of Cedar Falls. This number does not include the many suppliers who call on us and other visitors.

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Shannon, Ireland for $670 and we've paid the same amount to fly to Fort Lauderdale, the location of our Corporate Office.

I realize there are many factors that effect cost, one of which is certainly demand. We are in a dilemma, as the poor service and high cost continue it has not only a negative impact on future economic development but future development of existing firms as well. As you may know, Black Hawk County ranked number five in the Nation of counties losing population recently.

Another concern we have is the reduction in the quality of air craft, smaller planes as opposed to DC 9 jet service.

Without improvement and stability in air transportation in this area, our company, as well as many others, will continue to suffer economically and it will deter prospective newcomers from giving us serious consideration. Without economic development, this area will continue to decline.

I appreciate the opportunity to appear before you and hope that my comments have been helpful.

Senator HARKIN. Mr. Maahs, welcome from Des Moines.
Mr. MAAHS. Thank you, Senator Harkin.

STATEMENT OF DAVID MAAHS, ASSISTANT VICE PRESIDENT, GREATER DES MOINES CHAMBER OF COMMERCE FEDERATION

Mr. MAAHS. My name is David Maahs, assistant vice president for the Greater Des Moines Chamber of Commerce Federation. Connie Wimer, chair of the chamber federation, along with members of our air service task force, are in Des Moines today participating in Midway's inaugural flight activities. Otherwise, they would be here today. I'm here to provide testimony on their behalf.

The availability and affordability of air service is an important ingredient to the economic vitality of a region. It impacts existing business and new business development. Also, the ability of a community to attract regional and national conventions is directly correlated to the cost of air service.

As we all well know, we are competing in a global marketplace. Firms located in our communities have to compete on an international basis. Therefore, companies which have air transportation expenditures as a major portion of their operating costs are placed at a distinct disadvantage. In order to remain competitive, these businesses must compensate by economizing in other cost areas and by increasing the productivity of their workers.

In attracting new companies to a community, high air fares are a serious problem. When selecting a business location, site selectors evaluate communities based on a set of criteria. These are factors that are important to the long-term success of that business. If a community does not meet the criteria standards established by site selectors, it is eliminated during the early rounds of the screening process.

And I might add that often in these early rounds, communities really aren't even aware that they are being evaluated, so you don't have a chance to talk to them, so you lose out altogether.

Because of this screening process used, it is difficult to quantify the number of opportunities lost. But you can be assured that it is substantial, especially for some of the smaller communities in Iowa.

Transportation access, specifically, air service, is usually one of the factors included in the site selection criteria. For example, U.S. West is currently looking to establish a major research facility in its 14-State region which would employ up to 1,500 scientific and technical personnel and support staff. Their site selection criteria focus is primarily on five major considerations, one of which is air transportation. This is how it is phrased, "Beyond the quality of life considerations, a good transportation system is essential for a company to have access to its markets. U.S. West's particular need is for easy access to major metropolitan centers within the 14-State region. It also seeks ease of local, national and international travel for staff and visitors." This example underscores the importance air transportation has in economic development.

High air fares drastically reduce a community's ability to compete for convention business. Air travel is an important component in business travel. It often represents more than 50 percent of an

individual's travel expenditures. High air fares in Des Moines to certain destinations, such as Chicago, have been one of the major factors in the loss of numerous convention bids.

In Des Moines, one of our advantages is that we offer a cost per diem for breakfast, lunch, dinner, and lodging, which is 21 percent below the national average. Our cost per diem is $73.30, compared to a national average of $92.78. However, this cost per diem savings of $19.48 is more than offset by high air fares in some cases.

For example, if a convention delegate was to stay in Des Moines for 3 days, the delegate's cost for breakfast, lunch, dinner, and lodging would be approximately $220. If this delegate was flying from Chicago, a round trip air ticket would cost $440. This exorbitant air fare more than offsets the approximate $60 in savings that are accrued due to the lower per diem cost.

As you can see through this example, medium-sized cities with high air fares find it very difficult to compete for convention business. Just recently, the Greater Des Moines Convention and Visitors Bureau lost out in their bid to attract four regional or national conventions where the major factor for deciding against Des Moines was the high cost of air fares. These four conventions were: The Farm Equipment Manufacturers Association, Farm Power Equipment Dealers Association, the Association of Government Accountants, and the National Honorary Band Fraternity and Sorority, which would have generated in total $1.5 million dollars in convention delegate spending.

During the past 3 years, the Chamber Federation's Air Service Task Force has worked with existing carriers and potential new carriers in order to improve the quality and cost of air service. One of the biggest problem areas for the Des Moines business community has been the cost of air travel to Chicago, which is our largest single market, with about 10 percent of Des Moines' true origin and destination passengers.

This route is currently serviced by American Airlines and United Airlines. These two carriers have virtually the same pricing structure on this market. Both require a Saturday stayover in order to receive any discounts on price. Because it is inconvenient and often impossible for business executives to stay over Saturday night, they are faced with paying the coach fare which currently stands at $440 per round trip.

During the past year the Chamber's Air Service Task Force has worked with these two carriers and vigorously urged a reduction in price. Our plea has fallen on deaf ears. Our next strategy was to turn to another carrier and entice them to enter into this market. We are very pleased that our initiative has paid off with the attraction of Midway Airlines to Des Moines.

As of today, Midway will be offering four round trip flights from Des Moines to Midway Airport. At a minimum, their price is 30 percent less than the current charges. In addition, Midway offers a 14-day advance purchase discount which does not require Saturday stayover. The cost for this fare, as announced at the initial press conference, will be approximately $118 for a round trip flight.

In competing for new business and conventions, Des Moines often goes up against other major midwest cities such as Kansas City, Minneapolis, Omaha, and St. Louis. By and large, these cities have

cheaper air fares. In relation to other cities in the State of Iowa, we are thankful that we do have a number of carriers serving our market. In some cities in Iowa, any air service they do have is very expensive.

The current air pricing structure of the airline discriminates against business travelers. Business travelers often do not have the luxury of advance planning; therefore, they are faced with a substantially higher air fare. There are some other puzzling features concerning the current air structure.

For example, the lowest one-way coach fare from Des Moines to Chicago is $220, or $440 round trip. This is about the same fare that United and American charge for a flight to New York or Los Angeles from Des Moines. On the other hand, if you were to fly on United from Cedar Rapids to Chicago, the lowest one-way coach fare would be $63, or $126 round trip.

Competition between air carriers is vitally important to keep competitive air fares. Since deregulation, we have noticed that when there is a lack of competition for a certain segment of the market, the air fares are substantially higher. This was true for the Des Moines to Chicago market segment, which has now changed with the entrance of Midway. And it is currently the case with the Des Moines to St. Louis market, where the sole carrier now is TWA which charges $420 for a round trip coach fare, air fare, with no restrictions.

In working to attract new carriers to the Des Moines area, to service markets that need competition, we have found it is very difficult to attract smaller airlines because of the market strength of major airlines. Unless the new airline which is entering into a market has substantial financial backing, they find it very difficult to compete with a major airline for the following reasons. The major airline will immediately lower its price to match the new competition. In this case, most air travelers will stay with the carrier they are familiar with so they can participate in its frequent flier program. Even if the smaller airlines are more cost efficient and have a lower cost per mile, this competitive advantage is nullified if they are not able to fill up seats.

In summary, affordable air service is an important ingredient in economic development, and I hope my testimony today provides you with an insight on how the Des Moines area is impacted by today's air travel environment.

Senator HARKIN. Mr. Maahs, thank you very much for your testimony.

[The prepared statement of Mr. Maahs follows:]

REMARKS TO

COMPETITION AND ANTI TRUST ENFORCEMENT

SUB-COMMITTEE

SENATE COMMITTEE ON SMALL BUSINESS

June 1, 10 a.m.

University of Northern Iowa

By David Maahs

Assistant Vice President

Greater Des Moines Chamber

of Commerce Federation

My name is David Maahs, Assistant Vice President for the Greater Des Moines Chamber of Commerce Federation. Connie Wimer, chair of the Chamber Federation, along with members of our Air Service Task Force are in Des Moines today participating in Midway Airlines' inaugural flight activities. Otherwise, they would be here today. I'm here to provide testimony on their behalf.

The availability and affordability of air service is an important ingredient to the economic vitality of a region. It impacts existing business and new business development. Also,

the ability of a community to attract regional and national conventions is directly correlated to the cost of air service.

As we all well know, we are competing in a global market place. Firms located in our communities have to compete on an international basis. Therefore, companies which have air transportation expenditures as a major portion of their operating costs are placed at a distinct disadvantage. In order to remain competitive, these businesses must compensate by economizing in other cost areas and by increasing the productivity of their workers.

In attracting new companies to a community, high air fares are a serious problem. When selecting a business location, site selectors evaluate communities based on set of criteria. These are factors that are important to the long term success of that business. If a community does not meet the criteria standards established by site selectors, it is eliminated during the early rounds of the screening process. Because of this screening process used, it is difficult to quantify the number of opportunities lost. But you can be assured that it is substantial, especially for some of the smaller communities in Iowa.

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per diem savings of $19.48 is more than offset by high air fares in some cases. For example, if a convention delegate was to stay 3 days in Des Moines, the delegate's cost for breakfast, lunch, dinner and lodging would be approximately $220. If this delegate was flying from Chicago, a round trip air ticket would cost $440. This exorbitant air fare more than offsets the approximately $60 in savings that are accrued due to lower per diem cost.

As you can see through this example, small and medium size cities with high air fares find it very difficult to compete for convention business. Just recently, the Greater Des Moines Convention & Visitors Bureau lost out in their bid to attract 4 regional/national conventions. One of the major factors for deciding against Des Moines was the high cost of air fares. These 4 conventions which were the Farm Equipment Manufacturers Association, Farm Power Equipment Dealers Association, Association of Government Accountants and the National Honorary Band Fraternity & Sorority would have generated $1.5 million in convention delegate spending.

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Chicago which is our largest single market with about 10% of Des Moines' true origin and destination passengers. This route is currently serviced by American Airlines and United Airlines. These two carriers have virtually the same pricing structure on this market. Both require a Saturday stayover in order to receive any discounts on price. Because it is inconvenient and often impossible for business executives to stayover Saturday night, they are faced with paying the coach fare which currently stands at $440 per round trip.

During the past year, the Chamber's Air Service Task Force has worked with these two carriers and vigorously urged a reduction in price. Our plea has fallen on deaf ears. Our next strategy was to turn to another carrier and entice them to enter into this market. Were very pleased our initiative has paid off with the attraction of Midway Airlines to Des Moines. As of today, Midway will be offering 4 round trip flights from Des Moines to Midway Airport. At a minimum, their price is 30% less than the current charges. In addition, Midway offers a 14-day advance purchase discount which does not require a Saturday stayover. The cost for this fare, as announced at the initial press conference will be $118 for a round trip flight.

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have cheaper air fares. In relation to other cities in the State of Iowa, we are thankful that we do have a number of carriers serving our market. In some cities in Iowa, any air service they do have is very expensive.

The current air pricing structure of the airlines discriminates against business travelers. Business travelers often do not have the luxury of advance planning. Therefore, they are faced with a substantially higher air fare. There are some other puzzling features concerning the current air structure. For example, the lowest one-way coach fare from Des Moines to Chicago is $220 or $440 round trip (see attachment). This is about the same fare that United and American charge for a flight to New York or Los Angeles from Des Moines. On the other hand, if you were to fly on United from Cedar Rapids to Chicago, the lowest one-way coach fare would be $63 or $126 round trip.

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carrier now is TWA which charges $420 for a round-trip coach air fare with no restrictions.

In working to attract new carriers to the Des Moines area to service markets that need competition, we have found it very difficult to attract smaller airlines because of the market strength of the major airlines. Unless the new airline which is entering into a market has substantial financial backing, they find it very difficult to compete with a major airline for the following reasons. The major airline will immediately lower its price to match the new competition. In this case, most air travelers will stay with a carrier they are familiar with so they still participate in its frequent flier program. Even if the smaller airlines are more cost efficient and have a lower cost per mile, this competitive advantage is nullified if they are not able to fill up seats.

In summary, affordable air service is an important ingredient in economic development. I hope my testimony today provides you with an insight on how the Des Moines area is impacted by today's air travel environment.

AIR FARES IN MAY 1987

Lowest Applicable One Way Coach
Capacity Controlled
No Restrictions

	New York	Washington D. C.	Los Angeles	Chicago O'Hare	Dallas
Cedar Rapids	239	250	240	63	179
Des Moines	229	205	220	220	170
Dubuque	249	239	239	88	239
Kansas City	165	180	210	62	149
Minneapolis	199	179	215	119	185
Omaha	169	190	198	169	180
Waterloo	290	246	245	84	210

Source: International Travel Associates, Inc.

Senator HARKIN. Now we turn to Miss Lau. Miss Lau, thank you very much. Your statement will be made a part of the record in its entirety also. Again, I want to thank you for the research you did, and I think our people here today will certainly be interested in some of the findings that you have made. So I would just welcome you, and please proceed.

STATEMENT OF ELLEN M. LAU, PRESIDENT/SALES DIRECTOR, TRAVEL HEADQUARTERS, INC., DUBUQUE, IA

Ms. LAU. Thank you Senator Harkin. My name is Ellen Lau. I'm president of Travel Headquarters in Dubuque, IA, which is a retail travel agency. I've been a travel agent for 15 years, the last 13 of which I've been an agency owner. So since my experience predates deregulation I've been able to observe firsthand what effects this has had on my business.

In general I would say that deregulation has caused a deterioration in service and made it more difficult for business travelers and vacation travelers to get to their destinations. And actually, what was touted as being the major benefit of deregulation, lower fares for the consumer, may be the case in major markets, such as coast to coast, but in the smaller communities quite the opposite is true. We have higher fares and fewer flights.

For my clients to conduct their business it's essential for them to connect through O'Hare. Midway simply doesn't offer the number of flights to the number of cities that they require. And since I was not able to find any source that could give me a comparison of the two, I simply researched that myself by counting in the OAG, the Official Airline Guide, and I found the following.

O'Hare offers direct service to 195 cities, and an additional 79 cities are served by what we call on-line connections. That means, for instance, a Delta flight from O'Hare to Atlanta, connecting with another Delta flight from Atlanta to Gainsville. So that would mean that O'Hare offers 274 cities total, and it could be higher.

Midway I found offers service directly to 51 cities with 14 on-line connections, for a total of 65. So we are looking at 274 versus 65. And I found that not only is the frequency of flights less, but the type of service is less. In looking at several cities I find that while O'Hare might offer nonstop service, Midway offers flights that perhaps leave at very early hours and make several stops en route. And today's business traveler simply can't tolerate the time involved in that type of a flight. And then you add the difficulty of leaving out of a small community and connecting in Midway to those difficult destinations, it simply isn't possible.

So I would say it's essential that we have air service to O'Hare and the slots which are necessary to make that possible. I feel that without that, several businesses in Dubuque would undoubtedly relocate. And we have to consider that not only would we lose those direct jobs, but also businesses who supply goods and services to those industries would suffer from the lack of business and possibly the demise of their business.

We've had one business in Dubuque who did have to relocate their corporate headquarters to Phoenix. CyCare Systems found it so difficult getting their corporate people in and out that they

moved the corporate headquarters to Phoenix. And I've had an individual who was a frequent business traveler, worked for a company in Chicago, and he simply couldn't conduct his business as his company required and found it necessary to move to Chicago. And it would be impossible, I would say, to attract any new businesses to a community without this needed asset of service to O'Hare.

I think it's also important that these slots be granted to the city for which the service is being provided. Without it, if the slots are given to the airline providing the service, should that airline decide to leave the community, they could take that valuable public resource with them and we would be left in the same situation in the future. So I think that's an important point.

It might be unfortunate that Dubuque happens to be located so close, 175 miles from Chicago, since it's one of the four slot controlled airports in the Country. If we were located near Denver or Phoenix, we wouldn't be faced with this. But because we are, we have to deal with it. And I find that United and American operate 30 flights a day from O'Hare to LaGuardia, it's such a saturated market, and yet they can have 30 flights a day, and we have trouble getting three flights from Dubuque and Waterloo into O'Hare. It doesn't seem equitable.

Since the policy of buying and selling slots became effective, it seems as though only the major carriers are able to afford those slots. And actually, the airlines who were holding those slots when this policy became effective were given a tremendous gift. And they have been able to add that to their balance sheets and it gives them a bargaining power that smaller airlines simply will never be able to match.

And I would like to mention something about also the fare disparity between smaller cities and larger ones. Dubuque has lost a lot of its passengers to Cedar Rapids, since Cedar Rapids is served by several large airlines. And even though the difference might only be $40, that's significant as both companies try to control their costs and as vacationers are watching their budgets as well. And I compared fares from Dubuque, Cedar Rapids, and Chicago, to various cities. And I started with the lowest, highly restrictive fare, and on up to coach fare. In all cases, Dubuque is the highest, followed by Cedar Rapids, and then Chicago.

Just to list a few, starting with Atlanta, the lowest fares are: Dubuque, $238, Cedar Rapids, $198, and Chicago is $167. Austin, TX, is $218, $178, $187. Boston, $300, $260, $189. And so on it goes. It seems as though the smaller the city, the higher the fares. And it seems like the airlines determine their fares based on the amount of competition in the market.

When we were served by both—at that time it was called Republic Express, now Northwest Airlink, and United Express, we had a little competition, and then our fares were the same as Cedar Rapids. As soon as Northwest Airlink pulled out, United Express raised their fares again. Well, if they can offer the low fares when there is a little competition, why can't we have the same fares under all circumstances and then their load factors would go up, our passengers would stay in Dubuque. You know, it's like a vicious cycle.

In conclusion I would just like to say, first of all, I think the Essential Air Service Act should be extended indefinitely. I think without it, the smaller communities would be at a severe disadvantage.

Second, the Essential Air Service to Chicago should be formally designated as O'Hare, so that never again will we have this question of the Midway consideration.

Third, I think the slots should be given to the cities rather than the airlines.

And fourth, I think that the DOT needs to look at a policy of allocating new slots which become available as airports improve and enlarge, such as the new United terminal which is scheduled to open in O'Hare very soon.

So those are my major comments, and I would also like just briefly to mention that since United Express announced their pullout from Dubuque and then the DOT ordered them to stay, they have just very recently, over the weekend, in fact, put into effect a new schedule with diminished service which will become effective July 6, and we have fewer flights and at less desirable times of the day. So this is something else that we have to deal with. So I appreciate the opportunity to address this hearing.

Senator HARKIN. Thank you all very much.

[The prepared statement of Ms. Lau follows:]

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2095 John F. Kennedy Road • Dubuque, Iowa 52001

May 28, 1987

Senator Tom Harkin
316 Hart
U. S. Senate
Washington, D. C. 20510

Dear Senator Harkin:

Thank you for asking me to present testimony at the Subcommittee hearing on June 1, 1987 in Cedar Falls. I will be happy to present information on the effect of airline deregulation on airline service to small communities and on small businesses from a travel agent's viewpoint.

I have been a travel agent in Dubuque, Iowa for 15 years, 13 of those as an agency owner. Since my experience pre-dates airline deregulation, I have been able to observe its effects first hand. Generally speaking, deregulation has caused a deterioration in airline service and made it more difficult to travel to and from small communities by air. What was touted as being the major benefit of deregulation - lower fares for the consumer - may be true in large markets where there's a lot of competition, for instance New York to Los Angeles. But in smaller markets, as a result of deregulation, we have fewer flights and higher fares. The impact of this has been felt most by business clients who use the system a great deal more than vacation travelers. It is difficult enough to get from a small community to the large city (right now Dubuque has three flights to O'Hare and two return flights), but the difficulty is compounded flying from one small community to another small community.

In order for my clients to successfully transact their business, it essential for them to connect at Chicago's O'Hare airport. Many of their destinations simply cannot be reached from Midway airport. In order to provide some evidence of the difference between the two, I researched this by manually counting the cities served from each airport. I used an unbiased source, the May 15, 1987 edition of the Official Airline Guide (OAG), North American Edition. I spent over two hours carefully compiling this information as accurately as possible:

O'Hare serves:
195 cities with direct flights
79 cities with "On Line" connections (for instance, a Delta flight from O'Hare to Atlanta connecting with another Delta flight from Atlanta to Gainsville, FL)
274 cities total in North America

Midway serves:
51 cities with direct service
14 cities with on line connections
65 cities total in North America

It is important to note that this does not reflect the hundreds of international destinations which can be reached from O'Hare, none of which can be reached from Midway.

In this research, I discovered some interesting comparisons about the level of air service offered to/from the two airports:

1. Atlanta
   28 flights daily from O'Hare
   3 flights daily from Midway
2. Austin
   7 flights daily from O'Hare
   2 flights daily from Midway (each flight makes 2 intermediate stops)
3. Edmonton, Alberta
   O'Hare offers on-line connections through Minneapolis or Winnipeg.
   The only airline offering on-line connections from Midway is America West which requires that the passengers change planes in Las Vegas. (Most passengers object to traveling so far out of their way to reach their destination.)
4. El Paso
   2 flights daily to O'Hare, both of which are non-stop.
   2 flights to Midway on Southwest Airlines which cannot be booked through the computer. Booking can be accomplished only by calling Southwest and their lines are busy 99% of the time.
   a. Leave El Paso 6:45 AM
      Arrive Midway 12:00 Noon
      Makes 2 intermediate stops. Does not operate on Sat. or Sun.
   b. Leave El Paso 7:30 AM
      Arrive Midway 3:00 PM
      Makes 4 intermediate stops. Does not operate on Sun.
5. New York LaGuardia
   33 flights daily from O'Hare (30 of which are non-stop)
   8 flights daily from Midway (all of which are non-stop)
6. San Diego
   15 flights daily from O'Hare (10 of which are non-stop)
   3 flights daily from Midway:
   a. Leave Midway 6:45 AM
      Arrive San Diego 11:00 AM
      Southwest Airlines - makes 3 intermediate stops.No-op on Sun.
   b. Leave Midway 2:30 PM
      Arrive San Diego 7:10 PM
      Southwest Airlines - makes 4 intermediate stops
   c. Leave Midway 2:50 PM
      Arrive San Diego 6:20 PM
      United - makes 1 intermediate stop
7. San Francisco
   21 flights daily from O'Hare (16 of which are non-stop)
   6 flights daily from Midway - United operates 3 non-stop flights and Southwest operates 3 flights making either 2, 4 or 5 stops

Based on the above information, it is reasonable to conclude that today's business traveler could not tolerate the limited schedules offered at Midway Airport. Then add the complication of connecting from a small city like Dubuque with its limited flight schedule and the traveler is faced with an impossible situation. For this reason, I say that it essential for Dubuque to have air service to O'Hare (and the slots which make that possible). Without it, I am convinced that several industries and other businesses would find it necessary to relocate to cities with adequate air service. That would be an economic disaster to our community, not only in respect to the direct loss of those jobs, but in the loss of business and possible demise of the companies who supply goods and services to those industries, such as my travel agency.

It is important that the slots be granted to the city of Dubuque rather than to the airline serving that market. This would prevent any airline from taking those valuable slots with them should they decide to discontinue service to Dubuque sometime in the future.

It is perhaps unfortunate that Dubuque is located 175 miles from O'Hare, one of only four airports in the United States where landing slots must be purchased. If we were located near Atlanta, Denver or Phoenix, we would not be faced with the current problem. Perhaps this inequity points out a situation the DOT needs to address: guaranteeing landing slots for small communities located near the four slot-controlled airports.

At the time that the policy of buying and selling slots at these four airports became effective, the airlines holding those slots received a multi-million dollar gift from the DOT. The bigger the airline, the bigger the gift. This large addition to their balance sheets gives them bargaining power at those airports which will never be possible for smaller airlines serving small communities such as Dubuque and Waterloo. Is it equitable for United and American to operate 30 flights a day in the heavily saturated market from Chicago to New York when cities like Dubuque and Waterloo have so much difficulty getting 3 round trip flights to O'Hare? I submit that it not equitable and that the DOT needs to exercise better control over the situation.

Air service to a community has a tremendous impact on companies' ability to conduct their business. I know of one Dubuque business, CyCare Systems, that relocated their corporate headquarters to Phoenix due to their difficulty of flying in and out of Dubuque as our air service has deteriorated in the last few years. My agency lost a good commercial client, Richard Langheim, who was working as an engineering representative for a Chicago firm and found it so difficult flying to and from Dubuque, that he was forced to relocate from Dubuque to Chicago. I am sure these are not isolated incidents.

Good air service is an important factor in a company's decision to locate in a community. Without that necessary asset, a community is unable to attract any new business and therefore would suffer from an economic development standpoint.

I would like to address the subject of air fare disparity. Ever since deregulation began, it seems that the smaller the community, the higher the air fares are. Cedar Rapids, which is 70 miles from Dubuque, is served by several large air carriers and therefore has lower fares. Dubuque loses passengers to Cedar Rapids as a result. Sometimes the price difference is only $40, but as businesses try to control their travel costs and family vacationers try to save some money, that can be a significant factor in their travel planning. Following are sample fares which are effective 27 MAY 87. I have indicated a range of prices from the inexpensive and highly restrictive often non-refundable max-saver fares of which business travelers are rarely able to take advantage, up to full coach fare, round trip.

	From Dubuque	From Cedar Rapids	From Chicago
Atlanta	$238 - 640	$198 - 640	$167 - 619
Austin	218 - 690	178 - 650	187 - 669
Boston	300 - 822	260 - 782	189 - 641
Edmonton	410 - 706	347 - 532	292 - 642
El Paso	325 - 760	198 - 560	207 - 789
New York	278 - 700	238 - 660	207 - 589
San Diego	258 - 640	218 - 600	247 - 939
San Francisco	258 - 640	218 - 600	267 - 989
Toronto	238 - 355	238 - 322	120 - 273
Washington	278 - 700	238 - 660	207 - 549

I believe the airlines determine their prices based on the amount of competition in the market. So small communities with limited service and limited competition are at a disadvantage in respect to pricing. It seems like a vicious cycle: In small communities the prices are higher, so passengers choose to depart from mid-size or large cities and then the airlines complain because ridership is low in the small communities. The airlines have it within their power to increase ridership - all they need to do is lower the fares in small communities to the same price as neighboring mid-size communities, and their load factors would rise dramatically in the small communities. All travelers today are extremely price sensitive and I suggest that if the airlines tried offering competitive prices in small communities, they would be extremely pleased with the results.

In closing I would like to say:

1. I believe it is crucial that the Essential Air Service Act be extended indefinitely. Without it, in this highly competitive air travel industry, small communities would undoubtedly be left without adequate air service as the airlines scramble to serve larger, more profitable markets.

2. The Essential Air Service to Chicago should be designated as Chicago-O'Hare, so that there will never again be a question of Midway consideration.

3. The slots at the four slot-controlled airports should be allocated to the small communities served so that this valuable public resource cannot be stolen away by an air carrier.

4. The DOT needs a policy of allocating new slots which become available due to airport improvement and enlargement, such as the huge new United twin terminals at O'Hare scheduled to open soon.

I appreciate having the opportunity to present this testimony from the travel agents' point of view. I hope this information, coming from someone who works with it everyday as an intermediary between the airlines and the consumer and as a small business owner whose own economic well being is totally dependent on the travel industry, has been of some assistance.

Respectfully submitted,

Ellen M Lau

Ellen M. Lau
Travel Headquarters, Inc.
President/Sales Director

Senator HARKIN. Let me just pick up on that right here. The air service was scheduled to end on July 6. Then there was an extension date. Are you telling me now that because they were ordered to extend their service that they have now changed their schedules and they have diminished their service?

Ms. LAU. That's it.

Senator HARKIN. Well now, can you tell me more?

Ms. LAU. Would you like to know what time they are leaving, and so forth?

Senator HARKIN. What are the schedules now, for example? United Express, I think it's called.

Ms. LAU. That's right.

Senator HARKIN. What are their schedules now from Dubuque to O'Hare?

Ms. LAU. OK. Their first flight leaves Dubuque at 6:10 a.m., arriving in O'Hare at 7. They have another flight which leaves around noon time, arriving in Chicago-O'Hare at 1:14. Then they have an evening flight which leaves Dubuque at 5:55, arriving in Chicago at 6:45. Now, effective July 6, their first flight will leave Dubuque at 9:50 a.m.

Senator HARKIN. I don't believe it.

Ms. LAU. Arriving in O'Hare at 10:40 a.m. And then the only other flight will leave Dubuque at 7:55 p.m., arriving in O'Hare at 8:44 p.m. And I would like to say that not too many business people will begin their trips at 9 at night. Return schedules will no longer be nonstop. They will be via Moline. So the flights will come from O'Hare to Moline to Dubuque.

Senator HARKIN. Right now you said you can fly from O'Hare to Dubuque direct.

Ms. LAU. Right.

Senator HARKIN. How many times?

Ms. LAU. Twice.

Senator HARKIN. Twice a day.

Ms. LAU. Up until early April we had three flights. They took off the evening flight. So lately now we have been having two flights a day from O'Hare to Dubuque. One left at 9:45 in the morning, arriving Dubuque at 10:37. The other was an afternoon flight, departing O'Hare at 3:15, arriving Dubuque at 4:07.

Senator HARKIN. So now you are saying that now effective July 6, they will go through Moline?

Ms. LAU. That's right. So the new schedule is, the morning flight will leave O'Hare at 8:05 a.m., make that stop in Moline, and arrive in Dubuque at 9:38 a.m. And the evening flight will leave O'Hare at 6:15 p.m., stop in Moline and arrive in Dubuque at 7:43 p.m.

Senator HARKIN. Do these flights go on to Waterloo? Do these end at Dubuque?

Ms. LAU. I honestly don't know. It was so recent. I just looked it up.

Senator HARKIN. I just find this very disturbing. And I'll turn to somebody else. We will get you identified for the record. Here we thought we had a solution to this, at least for this link of the Waterloo to Dubuque to O'Hare, and this comes as news to me this morning. I did not know this. And you are saying that over the

weekend they have now juggled these schedules around so that now a business person, for example, can't leave on an early flight to get to Chicago early to connect on to something else, they have to leave at 9:50.

Ms. LAU. That's right.

Senator HARKIN. Or at 7:55 at night. There is no other noon flight.

Ms. LAU. That's right. Effective July 6.

Senator HARKIN. Well, I think something ought to be done about that. I just find that unconscionable.

Ms. LAU. It's very unworkable for business travelers, especially.

Senator HARKIN. Let's see if we can't do something about that. Again, that's just smacks of trying to get around what they were ordered to do by the DOT. Now, someone, I'm sorry, I'm going to get to you people here in a second, but someone in the audience really wants to say something. And I don't mind doing this for the record, but for the reporter I have to ask you to identify yourself.

Mr. CARTER. I'm Bruce Carter, director of the airport in here in Waterloo. And we found out the same thing this weekend, where presently United Express offers three flights a day to O'Hare, one leaving Waterloo at 9:20 in the morning, go through Cedar Rapids.

Senator HARKIN. That's now.

Mr. CARTER. Right.

Senator HARKIN. Give me those slowly so I can write them down.

Mr. CARTER. Effective now United Express runs three flights daily from Waterloo to Chicago, at 9:20 a.m. departs Waterloo, it goes through Cedar Rapids, arrives into Chicago probably around 11. The next two flights go through Dubuque, one leaving Waterloo at 11:40, and the other one leaving at 5:15 in the evening.

Effective on July 6 or July 7 we will be cut back to two flights a day to Chicago. The one departure out of Waterloo will be at 11:50 in the morning, going through Cedar Rapids to Chicago, getting in there probably around 1, 1:15. Then 3 hours later, at 2:50, departure out of Waterloo, a 2:50 departure out of Waterloo, to O'Hare, getting there approximately, 4, 4:30.

Senator HARKIN. Is that through Cedar Rapids again?

Mr. CARTER. Through Cedar Rapids again, right. So what we are having is, we are going to have two airlines within about 3 hours going to Chicago at very inconvenient times, coming from Chicago back—probably leaves Chicago around 10, going through Cedar Rapids, getting into Waterloo around 11:30, then turning around and going back.

Senator HARKIN. Counsel tells me that the law says that under essential service they have to provide two flights a day. But the spirit of the law is they should be at least at convenient times.

Mr. CARTER. Convenient times, yes. You can see here, very inconvenient times.

Senator HARKIN. Mr. Carter, thank you very much.

Mr. CARTER. Thank you.

Senator HARKIN. Actually, you can stay up there if you want, if you would like to join in on some of this stuff, add another dimension to this hearing.

I find that very disturbing. It just happened over the weekend. Again, it indicates to me that there is something going on here that we have to look into.

I want to get back to Mr. Frommelt and Mr. Tamisiea, because really this is the essense of what we are talking about here, economic growth and vitality for our smaller communities in Iowa, around the Country. You have been very loyal to the city of Dubuque, as you have been here in Cedar Falls for—how long has Viking Pump been here?

Mr. TAMISIEA. 75 years.

Senator HARKIN. 75 years here. You have 220——

Mr. FROMMELT. 300 employees.

Senator HARKIN. 300 employees. I'm sorry, I misstated. 300 employees. And you have 46 reps in the United States, they have about 300 sales people, you bring them into Dubuque for training and everything.

Mr. FROMMELT. Often, yes.

Senator HARKIN. I guess what I want to know is, now that you've heard about the airline schedule changes going out of Dubuque, as you are thinking about expanding—I hope you do, I hope you are able to do it in Dubuque—how much is something like this going to weigh on your decisions?

Mr. FROMMELT. Well, Senator, it's going to weigh very heavily on my decision. I said I have 15 people that travel, including myself. I travel about a hundred thousand air miles myself every year. And for those inconvenient times, it's just impossible. What we have to do is drive to Cedar Rapids. You rent a car, drive to Cedar Rapids, fly back into Cedar Rapids, rent a car to drive back home again. Very, very expensive, and impossible.

Senator HARKIN. Time consuming.

Mr. FROMMELT. Time consuming, and the time constraints are unbelievable. But to talk about bringing people into Dubuque, how that affects our business, for us to travel out, we can accomplish that by going at inconvenient times and at great expense, but to bring people in, for our representatives to sell our products, to bring people in, is economically disastrous. If you can't train people properly, you can't have them sell your product.

An example, air fare, I was in Boston this week, and it cost me $700 to fly round trip to Boston from Dubuque. I had to change my ticket in Boston. I went to the ticket agent and I said, "I'm going to change this a little bit." He said, "It's going to cost you $200 more." And he said, "You know, isn't it strange You can fly from Boston to San Francisco for $146." It's costing me now $900 to go from Dubuque.

When I have representatives in the Boston area that are going to send three and four and five people to Dubuque, that's impossible. What they will do and what they have done is send one person and they say, "We'll try, have him learn, and train the other people when he is back." And you see not only your profitability, but you see your business decline. You can't get away from it. It just—it isn't there. And for us to expand——

Senator HARKIN. Just giving a little bit different focus, and you can chime in if you want to, Mr. Tamisiea, but we speak of productivity of workers. Now, for the business person who has to travel,

train, cover expenses, that kind of thing, you make your product on the basis of how much they accomplish over periods of time. And I just wonder if you would address these issues in terms of productivity. Let's face it, we all travel a lot, and I know about my own product in my own job. If I've got to go to the airport and if I sit in an airplane waiting for an hour to take off, then I go some place, then I have to wait another hour, and I can't get in and out of some place, it takes me 2 days to accomplish something which should only take half a day.

Mr. FROMMELT. Let me comment on that for a moment. With the people I have travel, with my sales people, at one time they left home on Monday and came back home on Friday. With the air service the way it is, I lost Monday and Friday. So my people now leave home on Sunday and come back Thursday night. Cannot do it. It's impossible. I can't afford to lose Monday and Friday. And that's what I'm doing. I have a plant in Toronto, Canada. I can ship from the East just as cheap or cheaper than I can ship out of Dubuque.

Senator HARKIN. From Toronto.

Mr. FROMMELT. If I'm going to expand, I have got to look strongly at the Toronto expansion. It isn't in the cards for me to try to battle this day-in and day-out. That's what it amounts to.

Senator HARKIN. You mentioned you have about 400 flights.

Mr. TAMISIEA. Yes.

Senator HARKIN. And you mentioned the schedules don't tie into connecting flights.

Mr. TAMISIEA. The schedule that Miss Lau responded to here is another problem. Obviously we are going to spend another day away to get where we want to go because those flights don't interconnect, the connections through St. Louis and O'Hare. In the nature of our product, we are not a mass producer.

I mean, we service a wide spectrum of the economy from the petroleum industry to about everything you eat, whether it's peanut butter, making hotdogs, whatever. So we are kind of a specialized operation. As a result, we have to bring people in to see our facilities, see our R&D laboratories, and so forth, and that gives us an "upmanship" in having them here physically to see what we can do. And that is very costly. And it's costly for them.

With the distributors we have, they are constantly getting new salesmen. They have to come in here to be trained. They will be in here for a week or so. This is something that goes on, on a regular basis. Because of what's happened to the economy in this Country with the various manufacturing firms going offshore, the chemical processing industry, which is a major customer of ours, we are trying to get into new products so we can maintain the employment that we have and hopefully increase that. And as I mentioned earlier, to go out and try to market a new product these days is very expensive. And when you tack on the inconvenience of the air travel, that's just an additional cost.

And I would say in the future, I doubt if we would expand here because transportation is a very important factor to us. Not only because of the nature of our product, it's important that we get parts to pumps that already exist. If you have a refrigeration process and your pump goes to hell, you need a part, or you are going

to end up with a lot of spoilage. And a lot of our shipments out of here do go by air, and I'm sure the costs are greater because they probably have to go to Cedar Rapids, Des Moines, or other places.

Somebody was mentioning to me here early this morning there is a firm in Waterloo that I'm not totally familiar with, but it's called Metphath, M-e-t-p-h-a-t-h, they are a lab, and they have to send blood and urine samples to New York on a daily basis. And because of that they have to take them to Cedar Rapids to get the job done.

You may be familiar with one of our newer businesses that came here, Home Shopping Network, which is a TV sales operation. And they have tremendous difficulty in getting their flights from here out to the west coast, the western part of this Country. So here we were very happy in this area to get that firm located here, and whether they will stay or expand, I don't know.

But I think the story just goes on and on. And business is very competitive these days. We cannot pass price increases on, and so you have got to watch every dollar. And things are changing. All costs have to be watched. At one time we had over a thousand employees here. Now we are down to 650, and for many reasons. But I think a lot of it can be attributed to an inadequate transportation system. As I mentioned, being the largest SMSA and not having access to the interstate highway system has obviously hurt. Now we are getting the highways, but it makes you wonder what the highway is for, to bring people in or for people to exit. I think the same type of thing ties in with air transportation.

Senator HARKIN. Let me just ask a general question of you two, and also Mr. Maahs. We are going to hear testimony a little bit later from the Department of Transportation. I have an advance copy of the testimony. In their testimony they point out that—I take it, from the thrust of the testimony—travel is not that big of a factor with businesses, it's not that important.

For example, let me just read from their testimony. They say,

A study of responses to a Nebraska survey of industrial plants found that air passenger transportation rated 36th in importance out of 43 possible factors."

That was a study, I just might add, done in 1974.

In 1975 a study by the Minnesota Department of Aeronautics found air service accessibility in the bottom half of locational considerations listed for all types of industries and communities studied."

That was a 1975 study.

A 1975 NASA-funded study of general aviation impacts concluded that unless other frequently mentioned factors were present, it was unlikely that aviation facilities would aid in wooing industry.

These were all done in 1974 and 1975. I guess I'm wondering if things changed since then.

Mr. TAMISIEA. The World has changed. And unless you are going to be in a World market in our particular business, you are going to die. There is just no question about it.

Senator HARKIN. That's why I just find it somewhat misleading to cite these studies back in 1974 and 1975, because we all know everything has changed.

Mr. TAMISIEA. We are trying to protect what we have, and foreign competition is a very significant factor. We have competitors who are making pumps out of this Country who are using our engineering data and putting their name on the top of it.

Senator HARKIN. Would you say it's probably likely that they might be able to ship their products in cheaper and with more frequency than you can probably ship them out of here?

Mr. TAMISIEA. Yes. So to try to maintain our domestic market in the years to come it will probably be more difficult, because they are starting to send copies of ours into this Country. And our market has shrunk. It shrunk 5 percent last year. So that's why we are into new products and why we are trying to compete on an international basis, so we can get in their home and try and do a job there.

Senator HARKIN. This is really what we are looking at in this Subcommittee, how deregulation and what's happening in the airline industry right now is affecting rural areas of America. I'm talking about the Waterloos, Cedar Fallses, Dubuques, places like this. And I can even go beyond that, the Fort Dodges. I can go on to other States, too, in Nebraska and the Dakotas, how it affects them to really compete on an even level. And again, you might say, well, look, it's deregulation. It's an open competitive atmosphere. Well, is it?

United Express is now going, on July 6, to cut back their service and provide these two flights a day at odd times. I wonder if we gave these slots to the cities, rather than to the airlines, whether or not there wouldn't be another airline that would come in and say, wait a minute. We will give you service early in the morning and late in the afternoon. And that's what we want to look at, is there really a competitive atmosphere out there, or have we through deregulation moved into a very competitive atmosphere for certain corridors, such as San Francisco and Boston, and into a noncompetitive atmosphere for the smaller communities and rural areas of America?

Mr. FROMMELT. If you had the same advantages in manufacturing products, and if you could sell into one area and make more money than you could in another area, that's not a fair competitive edge. That takes away from you. That's exactly what the airlines are doing. The study made in 1975 or 1974 by the DOT, there has probably been 200 employees since then that have forgot about that study and are making new studies. I guess I get on Government bureaucracies because of that, and I don't mean to do that. Let's get away from that. Excuse me, DOT.

But for them to come out with a study and show that Essential Air Service, air service to small communities into major areas is not that important, when Mrs. Lau just gave a comment before about losing CyCare, you know, a major employer in Dubuque, their headquarters moves to Phoenix.

To talk to people that come into our area, my representatives, my sales people, that come in from outside—and first of all, they are very frightened about flying on a propeller airplane, anyway. We had jet service at one time. They can't believe—believe me, they can't believe there are communities that are not serviced by a jet airplane. They say, "Oh, my gosh, you can't be in one of those

areas." And then they say, "And you fly from him now?" That's frightening. They say, "That's not going to affect you much." DOT, that affects us greatly. When I have to have my people leaving home on Sunday in comparison with Monday, do it, do it some time with the family.

Senator HARKIN. Sure.

Mr. FROMMELT. It makes a difference.

Senator HARKIN. There are just a couple other things I want to cover with you. Could either one of you, or any of you, describe the difficulties you experience when air service from your community to your desired location is only available through Midway Airport rather than O'Hare? Have you had experiences with that at all?

Mr. FROMMELT. The only experience that we've had is that it's inconvenient flight times. Going into Midway is like going into an abandoned bus depot. I know Midway will probably all hear from them about it, but that's exactly what it is. And my people say, gee, do we have to? And if it's a connecting flight, you have to, yes.

Senator HARKIN. Mrs. Lau, 65 cities compared to——

Ms. LAU. 274 cities. So it's fine if it happens to work for where you are going. Like, for instance, I think from Midway to New York there are eight flights a day. Well, that might be a fairly logical connection. But so many times people are not going to those major hubs, they are going to some other smaller city, and it just is impossible to get there. I know that one of the cities I looked at was Edmonton, Alberta. Well, the only way to get from Midway to Edmonton is on America West via Las Vegas. People find this outrageous to think you have to go so far out of your way to connect. So it just means that Midway is not a viable alternative.

Senator HARKIN. It's not just only the number of connections, it's how long you have to wait to get a connection.

Ms. LAU. That's right.

Mr. TAMISIEA. I have not heard Midway Airport mentioned, so I'm sure that our people are not using it. To give you another example, I think it was last week we had five people coming in from Dallas. And because of the nature of the aircraft, there was fog here, they couldn't land in Waterloo, so they had to go to Des Moines.

As a result, the meeting scheduled for that day had to be delayed the following day, and they had to leave on a Friday night to get back to Texas. Certainly an inconvenience and an additional cost. Years ago, your expenses, you had a chance of increasing prices. And that's when we had soaring inflation. If things didn't quite work out you could say, well, we will just pass on the price increase. Those days are gone. They are gone. Our average price increase last year was less than 1.8 percent. And other costs are going up. And so what do you do? Well, you've got to do a lot of things in order to survive, let alone grow.

Senator HARKIN. Do you think there might be the possibility, travelers from small communities, the short-hop people from here to other smaller cities, might be in some way subsidizing the low fares that people from the big centers, like to New York or Los Angeles or San Francisco pay?

Mr. FROMMELT. Are you making a statement, Senator, or is that a question?

Senator HARKIN. Just throwing it open to speculation perhaps.

Mr. FROMMELT. That's a good statement.

Senator HARKIN. I just wonder about that. You mentioned conventions. I hadn't thought about that. Obviously both Des Moines, Waterloo—Des Moines and Cedar Rapids, at least, anyway, are considered convention centers. And I had never thought about the fact of losing out on convention sites because of the cost of air travel. That would be a big concern, especially if they had a lot of people coming.

Mr. MAAHS. Yes.

Senator HARKIN. So the advantages that we have in Iowa of low per diem is chewed up by the high air fares.

Mr. MAAHS. Yes, sir, quite rapidly. In Des Moines we do have a lot of carriers for people to choose from. We find that our problem is in situations where maybe one or two airlines are serving a city pair, Des Moines to Chicago, or Des Moines to some other city.

Senator HARKIN. So you have a lot of carriers, but there are only two from Des Moines to Chicago.

Mr. MAAHS. Exactly. And they provide currently the same pricing structure for just about everything on that. And they require a Saturday stayover. So if you have got delegates in Illinois, or some other cities, that might have to pass through there, you have a tough time competing for some of that convention business. And they are all—these delegates—you are competing with usually other major cities which might have better air service, or more carriers. So it puts you just one step behind them that you have to overcome.

Senator HARKIN. Any thoughts on solutions on things like this? Something that you'd like us to look into in terms of addressing these problems? If you don't have any right now, if you would think about it, let me know, I would appreciate it.

Mr. FROMMELT. Well, the city owning the slots. That would make a difference. We had at one time American Central in Dubuque. We had a number of slots. And I believe at that time, I don't know this for a fact, but I believe those slots were sold. They were at that time salable slots. And I don't understand the salability of slots. But if the city owned the slots it would make a big difference, yes, very much so.

Senator HARKIN. Good point.

Mr. TAMISIEA. I would agree with that.

Senator HARKIN. Mr. Maahs, would you agree?

Mr. MAAHS. Yes. In fact, when we were trying to encourage a carrier to serve Des Moines to Chicago, a number of the smaller carriers that we were working with said that going into O'Hare doesn't make economic sense for us, because of the high cost of the purchase of one of those slots. It's controlled.

Senator HARKIN. I'm going to ask DOT when they get up here about the slots. As I understand it, the slots were devised at these high density airports, four of them in the Country; is that right? But I don't understand how they got a price tag on them. I don't understand that.

Mr. FROMMELT. DOT would have to explain that to us, I think.

Senator HARKIN. I'll ask them. Miss Lau, I might ask, how many of your customers must drive to an airport in another town to get

the flights they need, and how often does this occur, and how far do they have to drive?

Ms. LAU. Well, I wouldn't have an exact count, but I can say that with a fair amount of regularity that they have to drive to—for us it's Cedar Rapids that they drive to. Cedar Rapids is 70 miles away. It's served by a number of major carriers, particularly going west.

And it used to be that only the vacation travelers would make that drive to save that $40 per person. But now, and sometimes the fare difference is greater than $40, that's about the minimum, with businesses and the budget constraints that they have, which the other gentlemen have talked about, even businesses are considering doing it. A lot of them have placed some kind of a dollar figure on it saying if we can save $50, you are going to drive to Cedar Rapids. They have to be very conscious of this fact.

And I know that the Dubuque Chamber of Commerce asked me to, last fall, contact the other travel agencies in Dubuque to kind of brainstorm a little bit about what our greatest needs and deficiencies are, and so forth. And in talking with the other travel agents, there are six agencies in Dubuque, and five of the managers said, "It's this fare difference that is just killing us, that we are losing so many passengers to Cedar Rapids." So it's just—our number 1 problem, I think, is our air fare disparity between Dubuque and Cedar Rapids.

Mr. FROMMELT. On maybe a minor note, I'm on the Board of Regents of a college in Dubuque. There are 20 people, a small number of people on that board, but never, we have meetings four times a year, has it not come up about the poor service to get to Dubuque. And there is—on many occasions we lose people attending those meetings. Again, on a very minor note. But, you know, what does that do to the outlook of these people looking at the city of Dubuque, IA? Maybe at the remotest that they would think about expanding into Dubuque, there is no way in the world they would even ask the question how do you get in and out of Dubuque? No way.

Talked to a man in the banking business the other day. The man in the banking business says, "You are fighting a losing battle. It's a losing battle. It's easier, rather than to fight to get the thing, it's easier to drive to Cedar Rapids." I said, "I don't believe that. We'll see."

Senator HARKIN. Well, we'll see also. I just can't believe that something can't be done to have a more efficient system to provide this kind of service to our smaller communities. As I said before we sat down here to an old friend of mine who is here today, I said, you know, we had great service one time, in Iowa, or smaller cities. I'll mention the airline. We had Ozark. Ozark provided great service in the State of Iowa. Great airline. And they didn't go bankrupt. I mean, they didn't go belly-up. They were making money doing what they were doing.

Mr. FROMMELT. With jets.

Senator HARKIN. With jets. That's right, with jets. And now for some reason we can't get that kind of service. Obviously, if we could make money at one time I would think we could make money now. These are the things we are going to look at, and we will try to figure out some way out of this dilemma.

Mr. CARTER. I would like to add one more note, Senator. An asset is, we do have three carriers that are very interested in serving the Waterloo/Dubuque market. The big question will be—is whether they can get the proper slots at convenient times for the customer. Because the airlines have indicated that they will provide good service at a decent fare, with the frequent bonus miles and things like that. So there are carriers presently looking at our markets.

Senator HARKIN. That is probably a good point to end on, because we are going to hear from one of those very shortly. Thank you all very much for coming. You have given us fine testimony. And anything else that comes up that you think we ought to know about, just please let us know. Thank you all very much.

Our Panel Number 2 will be Mr. Douglas Voss, president of Great Lakes Aviation, Inc., of Spencer, IA, and Mr. Jerome Mann, director of Air Transport Association, central region, Elk Grove Village, IL. He will be accompanied by Don Morrison, vice president of public affairs for Trans World Airlines.

First of all, let me ask you, again, on the record, were you all asked for 70 copies?

Mr. MANN. Yes.

Ms. BARKER. It's just a Committee rule. We don't require that many.

Senator HARKIN. Well, let's see how we can change that.

Anyway, Mr. Voss, welcome to the Subcommittee. You heard the last statement of the witness about other airlines looking at perhaps servicing these areas, and you are the president of an airline that has provided a great service to small communities throughout the state of Iowa, and I look forward to your testimony.

STATEMENT OF DOUGLAS G. VOSS, PRESIDENT/CEO, GREAT LAKES AVIATION, LTD., SPENCER, IA

Mr. Voss. All right. I would like to thank you, Senator Harkin, for giving us the opportunity to present Great Lakes' view relative to our view of the industry. I am, for those people that are not aware, Douglas Voss. I am president and chief executive officer of Great Lakes Aviation. As a background, Great Lakes is an Iowa based regional airline, and we are currently serving a total of eight cities in three States, Illinois, Iowa, and Minnesota, four of which are currently essential air service points. In three of the points we are the exclusive carrier in terms of essential air service, two of the points being subsidized, that being Ottumwa and Clinton. And we are an exclusive, unsubsidized carrier at Fairmont, MN. The other points that are served are: Fort Dodge, Spencer, IA; Des Moines; and we do serve Chicago-O'Hare and Minneapolis/St. Paul.

Great Lakes has been providing scheduled air service since 1981, and is currently operating a fleet of Beech C-99 aircraft, which many people are familiar with the older 99. The C-99 is an improved version of the aircraft, is still in production, and the aircraft that we are operating are less than 5 years old. Great Lakes Aviation is also a fixed base operator at three airports: Spencer, Fort Dodge, and a small airport at Spirit Lake, which is in Okoboji, the Iowa Great Lakes area. The name Great Lakes Aviation came from the Iowa Great Lakes area. We had originally a leasing corpo-

ration that we had used and we found that the name caught well, so we have been using it. A lot of the people question where we got the name. That's where it came from.

We also have, as another element to the company, a unique arrangement in that we provide airport management services at both Spencer and Spirit Lake. We have since September 1985, had considerable experience working with the slot environment at Chicago-O'Hare and we have some—I guess an opposing view to the community's standpoint relative to how the slots are handled. We can go into that later.

In the written statement I opened in trying to find a relatively common understanding so that I could balance my statements. I attempted to make clear that this particular situation is a pretty classic conflict of philosophy, and because of our position, that being airport management, airport and community tie due to the fact that we do have an interest, expecially in the Spencer and Fort Dodge areas, in trying to develop industry in that area, and a related commitment to that, and at the same time, we are operating an airline, which we are attempting to, on an ongoing basis, continue to make profitable.

The conflict is primarily generated from the elements of the community relative to the capabilities of the carrier. The community provides market-demand and you have your carriers having to recognize the demand as providing a pressure to influence you in whatever direction that it might take you in terms of trying to provide a profitable service.

One of the greatest problems that the industry is dealing with right now is related to the political and regulatory pressures currently pronounced—obviously, this hearing is regarding that—not aligning with the current management, airline management directions. The communities obviously are generating forces to balance changes, or trying to correct deficiencies in air service that are brought on by primarily profit and loss decisions made by airline management.

The ultimate side of this, from a community standpoint, is that if you can have a service guaranteed through some form of regulation, that it would be a practical thing, relative to what necessary costs are related to that. From an industry standpoint I would like to make it—or at least offer as a comment that from what I've seen of it, the industry participation in this up until this point has been somewhat limited, because the majority of the airline management has since 1978 operated in the ongoing deregulated environment with full intentions that that would remain so.

The EAS Program, being a part of the original deregulation, is naturally a portion that the major carriers expect to end. In October 1988 it is scheduled to end. With the interest that's currently out there, it appears that there will be some sort of a program that goes on. And in that regard I have some feelings relative to which direction it may take.

On a more specific basis relative to the written statement, I would like to say that there are some remaining independent regional carriers that are, in fact, recognizing that there may be a requirement for some form of re-regulation relative to the current structures of major carrier consolidation. The biggest problem re-

lates to major carrier and regional carrier marketing arrangements from the standpoint of still remaining an independent operator.

Given the current trend, further consolidation is going to reduce the regional carriers, or the number of regional carriers, either through mergers, buy-outs, or the direct or indirect forcing of bankruptcy. It must also be recognized that with the continued existence of code sharing, that it in and of itself is a form of consolidation, because it does not give effective control over a—it does give effective control over a financial carrier.

Some of the regional carriers that are operating in this environment have owner equity positions having been taken by the major carriers, which is offering—and really, this has taken place in the last 2 to 3 years, a new element as to what's going to happen within the regional carrier industry. But again, the point being, that even though your carriers may not be wholly owned, if you are attached to a major carrier you are without question being controlled by that major carrier, because if he was to for some reason pull the plug, your existence would most definitely be probably terminated.

Relative to the major carriers, it has to be recognized that today's hub systems have a built-in monopoly effect due to majority control of large markets by a major carrier from a given hub. The monopolies created from a consolidation are going to also lock out new start air carriers both through the market restraints and given the physical limitations of airport facilities, that being gate space, ramp space. There are only so many acres on an airport, and the development sometimes of which some of it has been hindered for necessary reasons, the other element relative to the airport constraints is in such cases the capacity controlled airports, limiting of air traffic capacity by flow control or your air traffic controllers.

Under the existing dual coding agreements between major and regional carriers, one of the greatest problems, which is also tied into the physical limitations, is the fact that exclusive rights to given market areas are granted within these agreements, which in and of itself prevents the potential competition at a given hub airport, especially if that hub airport is dominated by one particular carrier, which is normally true. In the case of Chicago you have got a unique amount of strength that somewhat balances itself with United and American. The majority of the rest of the hubs in the Midwest especially are primarily one carrier dominant.

This situation naturally prevents any new start regional carriers from obtaining what is in today's industry an absolute competitive must, that being a dual code marketing agreement with a designated carrier at a hub, that they offer the most connecting service. Again, recognizing that after recent mergers there may not exist a major or national carrier to assist—or may not be a major or national carrier in a competitive position to assist a new regional to develop in a given market area.

The other point is somewhat related to this. In terms of these dual code agreements, what's written in a high percentage of the ones that currently exist is that they absolutely prevent—or the major carriers requested that the dual coding carriers do not get involved with EAS points. In the case of Chicago we had exerted

efforts to try to improve our marketing strength at those points. And in both cases, due to the fact that we were serving EAS points, there was absolutely no interest and it was a written—it is in writing in several contracts—that carriers that are serving EAS points not be—they need to either remove themself from that type of service, and prevent themselves from going into that type of service. And that was, again, primarily related to the fact that the industry expected the termination of the program in October 1988.

And the ties relative to that, it becomes pretty much image related. If United Express was serving a given point and the subsidies were terminated, it damages the credibility of the major carrier, irregardless of the fact that it was being operated by a smaller regional carrier.

Current industry consolidation is and will continue to be a major influence to any new EAS Program, similar to the current format. It will undoubtedly reach a point where control of an EAS point will lie in the hands of a major carrier and its regional partner. Without the balancing effect of competition giving a somewhat similar scenario to what currently exists, the cost of subsidy will most likely increase and potentially could increase dramatically on a given EAS route.

The regional carriers that will—the regional code sharing carriers that would not have any incentive to try to hold down the costs of subsidy at points that would be—continue to be served with subsidized air service. The majority of the regional code sharing carriers, the primary reason they got involved was to try to grow.

And with every effort being in the direction of trying to improve service, and given the fact that as time goes by you strengthen—you try to strengthen your company and your employees by increasing your costs. It's just a natural portion of growth relative to wage increases and everything else. You eventually would drive yourself to the point where if subsidized service is going to be guaranteed, the subsidy will be in continuously increasing amounts. That's to say that there is not something that causes the major carriers to alter their current plans and make available or eliminate—by eliminating the exclusive rights to a market area so the Government at that point in time could get a competitive proposal for a particular point.

Given the current environment, the direction it is going, it's most likely going to eliminate the smaller carriers to the point where you will not have someone to bid against the code sharing carriers. One of the biggest problems that we found within the industry in recent years is the fact that your major air carriers currently do not have any incentive to assist in developing small community markets, and in many cases, through fare structures at competitive airports encourage traffic to drive to a non EAS airport for jet service and greatly reduced discounted fares.

With today's highway system, along with the new 65 mile-an-hour speed limit, the competitive capability of the car has been enhanced tremendously. It needs to be emphasized strongly that one of the major carriers' greatest marketing tools today and into the near future will be the car, because you can effectively control a market area which exists far outreaching of a given hub by the type of service and the fare structures that are offered there. It

does offer the consumer a greater ability to pick and choose at airports where competitive pressures bring major savings in transportation costs.

An EAS point being served by a single carrier that has an airport with more than two carriers at a distance, and I have—from our experience, and that's relative to markets such as Mason City, Spencer, Fairmont, Fort Dodge, we found that if you've got a competitive airport within 90 minutes driving time, you will be susceptible to major local passenger fluctuations. And to try to put that in focus, prior to the beginning of service of America West at what is now at Sioux City, they were serving Des Moines. And we at one time—22 percent of our connecting traffic at Des Moines was going to America West. When they began serving Sioux City our boardings at both Fort Dodge and Spencer decreased overnight with the change in the service. And———

Senator HARKIN. Because they drove to Sioux City you are saying, or what?

Mr. Voss. Yeah. There is naturally a lot of reasons for this, primarily the fare and given the time element and the type of equipment that we were operating, some people that are opposed to operating this—or flying in the small airlines. But the 90-minute element seems to be the window that we are finding that affect how the service is utilized. One of the side effects again of this is that this particular situation would in a future EAS Program potentially open a major avenue of increasing subsidy if the carriers want to manipulate it, to do that, not to say that that would be their intentions, but it could potentially work in that direction.

What I'm saying there is that given the fact that they are guaranteed a profit element, or there is an attempt to guarantee a profit element at an EAS point, the EAS Program is going to offer a tool to suppress a market and control revenue estimates for bidding at rate conferences for a subsidized market. An example of something like this, a scenario like this would be that if you are serving an airport let's say an hour from an EAS point, you could potentially—from an airline standpoint you could potentially raise your fare at the EAS point to a level where it will not get utilized, but at the market 50, 60 miles away you might have the fare at half.

You would do that for several reasons, probably due to the size of the market, that and given the competitive pressures. Well, if you had control over a market area and given the fact that EAS points tend to be assigned to a given hub, you could effectively raise your subsidy in the one market and take the passengers out of the community and put them on your same airline 50, 60 miles away, which is sort of a double whammy effect.

Senator HARKIN. Can I ask you to wrap up here?

Mr. Voss. What's that?

Senator HARKIN. Can I ask you to wrap up here, this last paragraph? I'm just looking at the clock and the time on this.

Mr. Voss. The insistance by communities to continue the EAS Program is natural, and given the competitive benefit to the community, we would like to offer one—what in our opinion is a fair comment. We feel that if there is going to be a subsidized Federal program, that the community should be looked at for a portion of

that in order to—as we have experienced, in some cases, communities do not tend to have that great of an interest in maintaining their own air service.

With this testimony, we've attempted to summarize what we believe is an intensely complex subject, and at the same time we would like to make it known that we would offer our time to answer any questions now and into the future relative to our position in this.

[The prepared statement of Mr. Voss follows:]

GREAT LAKES AVIATION Ltd.

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June 1, 1987

Senator Tom Harkin
Chairman
Competition and Antitrust Enforcement Subcommittee
Committee on Small Business
Washington, D.C. 20510-6350

Background:

1. Great Lakes Aviation is an Iowa based Regional Airline currently serving a total of 8 cities in 3 states, 4 of which are Essential Air Service points, 3 points as the exclusive carrier, 2 points served with subsidy.

2. Great Lakes Aviation has been providing scheduled Air Carrier Service since 1981, and is currently using Beechcraft C-99 Aircraft on its route structures.

3. Great Lakes Aviation is also a Fixed Base Operator at 3 Airports (Spencer, Fort Dodge, and Spirit Lake, Iowa) providing fuel, maintenance, charter, flight instruction, and other misc. daily airport services.

4. Great Lakes Aviation under contract, provides Airport Management Services at both Spencer and Spirit Lake, Iowa.

5. Great Lakes Aviation has been serving the capacity controlled airport (slots) of Chicago O'Hare since September of 1985.

Comments:

"Essential Air Service and Airline Antitrust"

Let me begin by saying both of the current issues being commented on in this testimony are classic examples of conflict of philosophy. One side desires the Government to protect and insulate communities, and in some cases airline employees, from the volitility of the Airline Industry free market system, of which it has previously not had to be exposed. The other side, that being, the Airline Industry and the perpetual desire of each airline to grow and increase market share and at the same time acheive a "Profit" to further feed the fires of change. This is normally, without governmental influence, to be accomplished by offering the best and most attractive service for the least possible cost to the customer. Recognizing that todays consumers are increasingly more intelegent and cost concious, or in otherwords, wanting "more for less".

The industry attempts to recognize all of the "Market Pressures" and adjust itself to the "Market Demand". The influence of political and regulatory elements naturally are a part of the market pressures.

One of the greatest problems the industry must deal with is the potential of political and regulatory pressure not falling into line with practical airline management.

The communities, on the other hand, generate forces that may try to balance changes brought on by airline management. The primary reason for this ultimately returns to a simple philosophy of why risk anything when you can have a sure thing guaranteed by a regulatory system. The communities recognize that they must balance the cost of the guarantee with what is perceived politicaly as being acceptable.

Recognizing that recent industry participation in this issue has been limited because the majority of the airlines expected the deregulation process, including the ending of the EAS program, to be completely carried out, the following comments and suggestions are hereby offered for further discussion.

1. Some of todays remaining Independent Regional carriers are in fact recognizing that there may be a requirement for some form of reregulation relative to the current structures of major carrier to regional carrier marketing relationships. Current industry consolidation will further decrease the number of regional carriers that currently exist either through mergers, buyouts, or bankruptcies. It also must be recognized that with the continued exsistance of code sharing, that it, in and of itself, is a form of consolidation because it does give effective control over a regional carrier (either with or without partial ownership) by the major carrier partner.

Todays Hub systems have a built in monopoly effect due to majority control of large markets by a major carrier from a given hub. The monopolies created from the consolidation will also lock out new start air carriers both through the market restaints and the physical limitations of airport facilities, including airport air traffic capacity. Under existing dual codeing agreements between major and regional carrier's, "exclusive rights" to a given market area are granted. The situation naturally prevents any new start regional carriers from obtaining, what is in todays industry an absolute competitive must, that being a dual code marketing agreement for a designated hub with the carrier offering the most connecting service. Again recognizing that after recent mergers their may not exsist a major or national carrier in a competitive position to assist a new regional to develop in a given market area.

2. Current industry consolidation is, and will continue to be a major influence in any new EAS program simular to the current format. It will undoubtably reach a point where control of an EAS point will lie in the hands of both the major carrier and its regional partner.

Without, the balancing effect of competition the cost of subsidy will increase dramatically irregardless of traffic development on a given EAS route. The regional carriers will have no incentive to hold and control costs and will in times of financial difficulty use the government as a saftey valve to insure its profitability. In order to counteract this possibility there must exist within EAS or antitrust language a tool that negates the effect of exclusive market area agreements between a regional and a major carrier to such extent possible.

3. Major air carriers currently do not have any incentive to assist in developing small community markets and in many cases will, through fare structures at "competitive airports", encourage traffic to drive to a non EAS airport for jet service and greatly reduced discounted fares.

With todays highway system along with the new 65 mph speed limit the competitive capability of the car has been enhanced tremendously. It cannot be emphazised enough that one of the major carrier's greatest marketing tools today and into the future will be the car. It offers the consumer a greater ability to pick and choose at airports where competitve pressures bring major savings in transportation costs.

An EAS point being served by a single carrier that has an airport with more than two carriers at a distance less than 90 minutes driving time will always be susceptable to major local passenger traffic fluctuations, due to the competivness of the car and the nearby airport. This situation also opens a major avenue to increasing subsidy, if one of the competing carriers at the nearby competive airport also happens to exclusively serve the EAS point. There will be no incentive to develop the EAS point and in fact the EAS program will offer a tool to suppress a market and control revenue estimates for bidding and rate agreement purposes relative to subsidy contract. This situation is obviously further exacerbated by a code sharing regional not having competition in a given EAS hub market and the development of regional competition blocked by exclusive contractual agreements between the dominent major and its code sharing partner.

4. Insistance by communities to continue the EAS program is only natural. Airline service is without question a major advantage in attracting and developing new industry. Given the competitive benefit to the community of such service it should be considered only natural and fair that a federaly supported program should have cost sharing and in a future program be available to any city which demonstrates a practical need and not just those that have been grandfathered into a guaranteed air service.

We have in this testimony breifly attemped to summarize a very complex subject and yet make known our most major concerns relative to the intent of these hearings. We are most willing to participate in any future discussions and will do our best to answer any questions relative to our position.

Respectively Yours:

Douglas G. Voss
President/CEO

Senator HARKIN. OK, Doug. Thank you very much. Let me turn to Jerome Mann, director of the Central Regional Air Transport Association of Trans World America, and you have Don Morrison with you. Please proceed.

STATEMENT OF JEROME F. MANN, DIRECTOR, CENTRAL REGION, AIR TRANSPORT ASSOCIATION OF AMERICA, WATERLOO, IA, ACCOMPANIED BY DON MORRISON, VICE PRESIDENT OF PUBLIC AFFAIRS, TRANS WORLD AIRLINES

Mr. MANN. Thank you. My name is Jerome Mann and I'm the director of the Central Region Office of the Air Transport Association of America, better known as ATA. With me is as the Senator indicates Don Morrison, vice president of public affairs for Trans World Airlines. Before I continue, we would like to request of the Subcommittee that the record be kept open for a reasonable period of time. We want to submit in writing much more documentation on this very serious subject.[1]

Senator HARKIN. Without objection the record will be left open. I already promised Senator Levin from Michigan that I would leave it open. So we will leave it open for a reasonable amount of time. We will leave it open for 15 days, or however long until——

Mr. MANN. We will be prompt in our submission.

Senator HARKIN. A couple weeks.

Mr. MANN. Our association, which is a trade and service organization of 27 air carriers, welcomes this opportunity to express our views on the important subject of small- and medium-size community air service, and in particularly the situations here in Waterloo and also in Dubuque.

Given the timeframe in which our time comments were requested, however, I will not be able to specifically address in detail some of the more global issues in which you have expressed an interest, such as general Department of Transportation policies, competitive forces at work in the marketplace, and the distribution of slots restricting carrier access at certain major airports. To the extent relevant, I have, however, attempted to incorporate some perspective on these matters into these remarks.

At the outset, it's fair to say that the airline deregulation has been a tremendous success from the standpoint of the general consumer. In the space of less than 10 years, the carriers in this Country have been converted from a means of transit primarily utilized by a select clientele, to what is now truly a means of mass transportation. Passenger traffic has skyrocketed from 275 million in 1978 to 415 million in 1986. A projection of 600 million passengers per year in 1990 is more than realistic.

On the issue of price, 90 percent of those 415 million passengers carried last year utilized some form of discount airfares. The discounts averaged roughly a 60 percent reduction off the basic price of transportation at a combined savings to passengers of some $3 billion.

And what about the state of airline service in Iowa? Department of Transportation data indicate that every service Iowa has, in fact,

[1] Material not available at time of going to press.

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increased approximately 9 percent in terms of air operations since the 1978 airline deregulation act. The emergence of airline hub airports and the cummuter and regional airline feed into that system has played a dominent role in this expansion. The utilization of smaller aircraft by these specialized operators has enabled them to increase efficiency, while also increasing the number of weekly operations at 6 of the 12 Iowa cities receiving certificated air service at the time the Deregulation Act was enacted.

In this regard, it is worthy of particular note that commuter and regional carrier passenger feed into major carriers' hub and spoke operations has produced a variety of highly beneficial marketing agreements between all of the carriers involved. These carriers' operations complement one another and are an essential element of small- and medium-size community air service.

Statistics such as these while important, of course, offer cold comfort to a small- or medium-size city faced with a threatened withdrawal of some or all air service. That is why we are here today. The Congress and the major airlines were aware from the outset of deregulation that the introduction of market forces in place of deregulation as a means of allocating a valuable commodity such as air service could produce unsettling results. To deal with this problem and to afford transportation policymakers with the necessary tools to avoid catastophic reductions in local service, the Deregulation Act, as you know, incorporated an Essential Air Service Program. This program, which has strong endorsement of the ATA carriers, permits the Department of Transportation to subsidize badly needed local air service under appropriate circumstances, which such service might otherwise not be self-sustaining.

In the cases of Waterloo and Dubuque, however, while the EAS program may play a role in assuring the maintenance of service in the near term, it is not the inability of the local economies to sustain air service that is at the root of the problem. In point of fact, I understand that there are three carriers waiting in line to take the place of the carrier intent on leaving these markets. The problem, rather, is on the receiving end of this traffic, O'Hare Airport in Chicago and the national aviation infrastructure.

The obvious problem at O'Hare, of course, is the artificially constrained ability of carriers to operate under the so-called High Density Traffic Airport Rule. This DOT rule, which was intended as a short-term solution to airport delays in the late 1960s, allocates among carriers limited rights to operate an arbitrarily set number of flights at O'Hare and three other major airports.

As a result of the rule, carriers serving cities, such as Waterloo and Dubuque, must not only determine that their service can be economical to a given city, but also that the service represents the most efficient utilization of the valuable O'Hare slot. As a result, of course, the slot tends to distort market forces to the disadvantage of small- and medium-size communities, which might otherwise receive service.

I should point out that the EAS service, or Essential Air Service Program, recognizes this impact of the slot system and does permit the creation of slots exclusively for such service. The complex interplay between such Essential Air Service slots, non-Essential Air Service slots, carrier competition, and the local and national politi-

cal concerns, however, has made the Department of Transportation extremely reluctant to move precipitously in this area to create new slots.

Arbitrary slot restrictions at O'Hare and elsewhere, which we believe should be eliminated with all due haste, are, however, in the final analysis a mere symptom of a much larger problem confronting our national air transportation system. The real culprit, in our view, is the woefully inadequate infrastructure upon which we all must depend to move aircraft and passengers efficiently. This infrastructure, the air traffic control and airport system, is clearly not up to its task. And the situation is growing worse every day.

It is unfortunately true that the airport delays of the late 1960s and early 1970s, which fueled the High Density Traffic Airport Rule, were to be resolved, once and for all, through the establishment of the Airport and Airway Trust Fund in 1970. That fund, established exclusively with user payments, was intended to provide a permanent source of adequate funding for the capital improvements essential to an efficient airport and airway system. In the ensuing 17 years and despite intermittent congressional adjustments to the legislation attempting to make it work, the system is, if anything, now less capable of responding to demand. This inability to respond to demand was an unworkable situation in an era of regulated air service. With airline deregulation, it is an unconscionable one.

Using O'Hare as an example, there are a number of steps which should be taken immediately to improve operating capability, particularly during periods of reduced visibility, such as upgrading the Instrument Landing System on runways 4 right, 32 left and 14 left. While such improvements will not correct the slot problem, they may provide a partial impetus to its ultimate elimination.

Unfortunately, the funds already paid by the consumers for improvements such as these have not been made available to fulfill the need. The ironically named Aviation Trust Fund now contains a surplus balance in excess of $5.6 billion paid in to improve the infrastructure. This money, held hostage for the politically expedient purpose of making the Federal budget deficit appear smaller, is urgently needed to properly finance improvements of our Nation's air traffic control and airport systems. Such improvements are absolutely essential if we are to maintain the benefit of optimum levels of air service not only to communities like Waterloo and Dubuque, but also to the Nation at large.

The member carriers of the Air Transport Association are convinced that the time has come for a fundamental change in the way this Country manages and funds its air traffic control and airport systems. Such change must incorporate a direct linkage between system demands and the level of funding, along with the introduction of a more flexible and efficient management structure. Adherence to the proven ineffective programs of the past will destine all of us to a future of ever worsening air service.

The air transportation industry, the American people and the Government can no longer afford a compromise. We must fix the system now. We would urge this Subcommittee to do everything within its power to see to it that these such fundamental changes are given serious consideration by the Congress.

On behalf of our members, I would like to thank you for the opportunity of appearing before you to discuss this important issue. Now, Don Morrison and I would be pleased to respond to your questions.

Senator HARKIN. Thank you very much, Mr. Mann.

[The prepared statement of Mr. Mann follows:]

Statement of Jerome F. Mann
Director - Central Region
Air Transport Association of America
Before the Competition and Antitrust
Enforcement Subcommittee
Committee on Small Business of the
United States Senate
Waterloo, Iowa
June 1, 1987

Good morning. My name is Jerome Mann and I am the Director of the Central Region Office of the Air Transport Association of America (ATA). With me today is Don Morrison, Vice President of Public Affairs for Trans World Airlines. Our association, which is a trade and service organization of twenty-seven air carriers, welcomes this opportunity to express our views on the important subject of small and medium size community air service, and in particular the situations here in Waterloo and also in Dubuque.

Given the timeframe in which our comments were requested, however, I will not be able to specifically address in detail some of the more "global" issues in which you have expressed an interest, such as general Department of Transportation policies, competitive forces at work in the marketplace and the distribution of slots restricting carrier access at certain major airports. To the extent relevant, I have, however, attempted to incorporate some perspective on these matters into these remarks.

At the outset, it is fair to say that airline deregulation has been a tremendous success from the standpoint of the

general consumer. In the space of less than ten years, the air carriers in this country have been converted from a means of transit primarily utilized by a select clientele, to what is now truly a means of mass transportation. Passenger traffic has skyrocketed from 275 million in 1978 to 415 million in 1986. Projection of 600 million passengers per year in 1990 is more than realistic.

On the issue of price, 90 percent of those 415 million passengers carried last year utilized some form of discount airfares. The discounts averaged roughly a 60 percent reduction off the basic price of transportation -- at a combined savings to passengers of some $3 billion.

And what about the state of airline service in Iowa? Department of Transportation data indicate that air service in Iowa has, in fact, increased approximately 9 percent in terms of air operations since the 1978 Airline Deregulation Act. The emergence of airline hub airports and the commuter and regional airline feed into that system has played a dominant role in this expansion. The utilization of smaller aircraft by these specialized operators has enabled them to increase efficiency while also increasing the numbers of weekly operations at six of the twelve Iowa cities receiving certificated air service at the time the Deregulation Act was enacted.

In this regard, it is worthy of particular note that commuter and regional carrier passenger feed into the major carriers' hub and spoke operations has produced a variety of

highly beneficial marketing agreements between all of the carriers involved. These carriers' operations complement one another and are an essential element of small and medium size community air service.

Statistics such as these while important, of course, offer cold comfort to a small or medium size city faced with a threatened withdrawal of some or all air service -- and that is, after all, why we are here today. The Congress and the major airlines were aware from the outset of deregulation that the introduction of market forces in place of regulation as a means of allocating a valuable commodity such as air service could produce unsettling results. To deal with this problem, and to afford transportation policy makers with the necessary tools to avoid catastrophic reductions in local service, the Deregulation Act, as you know, incorporated an Essential Air Service program. This program, which has the strong endorsement of the ATA carriers, permits the Department of Transportation to subsidize badly needed local air service (under appropriate circumstances) which service might otherwise not be self-sustaining.

In the cases of Waterloo and Dubuque, however, while the EAS program may play a role in assuring the maintenance of service in the near term, it is not the inability of the local economies to sustain air service that is at the root of the problem. (In point of fact, I understand there are three carriers waiting in line to take the place of the carrier

intent on leaving these markets.) The problem rather is on the receiving end of this traffic -- O'Hare Airport in Chicago and the national aviation infrastructure.

The obvious problem at O'Hare, of course, is the artificially constrained ability of carriers to operate under the so-called High Density Traffic Airport Rule. This DOT Rule, which was intended as a short term solution to airport delays in the late 1960's, allocates among carriers limited rights to operate an arbitrarily set number of flights at O'Hare and three other major airports. As a result of the rule, carriers serving cities such as Waterloo and Dubuque must not only determine that their service can be economical to a given city, but also that the service represents the most efficient utilization of the valuable O'Hare slot. As a result, of course, the slot tends to distort market forces to the disadvantage of small and medium size communities which might otherwise receive service.

I should point out that the EAS program recognizes this likely impact of the slot system and does permit the creation of slots exclusively for such service. The complex interplay between such EAS slots, non-EAS slots, carrier competition and local and national political concerns, however, has made the Department of Transportation extremely reluctant to move precipitously in this area to create new slots.

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problem confronting our national air transportation system. The real culprit, in our view, is the woefully inadequate infrastructure upon which we all must depend to move aircraft and passengers efficiently. This infrastructure -- the air traffic control and airports system -- is clearly not up to its task. And, the situation is growing worse every day.

It is unfortunately true that the airport delays of the late 1960's and early 1970's -- which fueled the High Density Traffic Airport Rule -- were to be resolved, once and for all, through
the establishment of the Airport and Airway Trust Fund in 1970. That fund, established exclusively with user payments, was intended to provide a permanent source of adequate funding for the capital improvements essential to an efficient airport and airway system. In the ensuing seventeen years, and despite intermittent Congressional adjustments to the legislation attempting to make it work, the system is, if anything, now less capable of responding to demand. This inability to respond to demand was an unworkable situation in an era of regulated air service -- with airline deregulation it is an unconscionable one.

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On behalf of our members, I would like to thank you for the opportunity of appearing before you to discuss this important issue. Mr. Morrison and I would be pleased to respond to your questions.

Senator HARKIN. Let me start first with you, Mr. Voss. You said you had a different view on how slots are handled. One more time, tell me how you think these slots now—from what I understand from Mr. Mann, he just wants them eliminated; right?

Mr. MANN. Altogether, just as quick as we can, let's get rid of them.

Senator HARKIN. Let's get rid of them, and I'm going to come back to that and want to talk to you about that. How did you say you thought they ought to be handled?

Mr. Voss. Well, one of the biggest problems is internally handling a system that would allocate them to communities, because you are going to run into—immediately into a problem where everyone wants to arrive or there is the potential to have 350 flights arriving at Chicago-O'Hare at 9.

So you are going to end up having to disperse them most likely due to market size in order to allow it, because the airport capacity is—the ATA position is obviously very strong, or at least in the belief of the carriers, in that without the improvements at the airports you are not going to be able to adjust—well, giving the carriers effective control over the adjustments of time—of the times of the slots, are going to allow you to try to structure it more so toward a profitable arrangement, rather than to be delivering point——

Senator HARKIN. So what you are saying, excuse me for interrupting, what you are saying is that you disagree with the slots being assigned to communities.

Mr. Voss. Right. I don't see how that's a workable arrangement. It's not——

Senator HARKIN. How about the present system where airlines have the slots and they can buy and sell them?

Mr. Voss. The buying and selling of the slots in and of itself is a fairly lengthy issue. I guess that if you were to study the amount of transactions that were taking place, you would find that there is not that much activity relative to it. It's not being used as a tool to try to get rich quick. It's more of an adjustment.

In most cases the carriers that were selling the slots were losing money in markets that were not producing enough revenue to justify the continuing ongoing usage of the slot. And relative to the available capital, it was easier to sell the slot than to try to maintain an operation that was most likely unprofitable, especially if it was in a competitive market.

Senator HARKIN. Let me ask you a couple of general questions, Mr. Voss. What effect do you believe the current deregulated airline market, wherein many of the larger airline companies have merged, leaving only six or seven major airlines, what effect does this have on the ability of a small airline company to enter the market and survive on its own? Now, you talked about the codesharing.

Mr. Voss. Right. In terms of new-start air carriers, I quite frankly do not conceive under the current environment anyone being able to make a successful go at it. If you look at the recent track records of the carriers that came to be after deregulation, you will find that most of them have failed, the majority. The ones that have remained have found through one means or another a way to

align themself with one of the six or seven major carriers that effectively have control over the majority of the traffic. And the remaining carriers that are independent are all in a fairly mad scramble to try to find an attachment to a carrier in order to continue to survive.

Senator HARKIN. And that really is the question that this Subcommittee is looking at. Is that a competitive situation?

Mr. Voss. Yeah, I believe they are.

Senator HARKIN. No, I mean, you are saying they are tied in with the major carriers. And I'm just asking does that promote competition if you are tied in with six or seven major carriers.

Mr. Voss. Well, it does, and at this point in time, in selected areas. The ability of a major carrier to reach into a market that it can't justify reaching into with its own equipment comes with the alignment with the smaller regional carriers through the current code sharing arrangements a more competitive position. If a major carrier was to try to do that, it would be economically unpractical.

Senator HARKIN. Code-sharing contracts are contracts made between a small carrier and a major airline. It appears that code-sharing contracts maybe tie-in contracts, which requires a small airline to agree to certain contract provisions or else they lose that contract, they lose the code sharing. According to the counsel, tie-in contracts are illegal under antitrust laws as a restraint of trade. So if code sharing are, in fact, tie-in contracts, it would seem to me that would be a violation of trade. But I leave it at that and I will come back to Mr. Mann on that, if you would like to comment on that, at all, Mr. Mann, on the aspect that code sharing contracts between a major carrier and a smaller carrier are really a tie-in contract. Tie-in contracts have for a long time been viewed as a violation of antitrust laws. Mr. Morrison?

Mr. MORRISON. Senator, I'm not sure that I can really answer that, obviously, from a legal standpoint. I think that the code sharing arrangements that all of us have today is primarily a marketing agreement and not really a total tie-in contract. But again, I would leave that to further evaluations from ATA and others on the legal issue.

But the contract that we have with the commuters that we have, the code sharing arrangement is a marketing agreement, not an operational agreement. We don't control their operation, per se. It's an operation that we basically work together on a marketing arrangement, farewise, feewise, and so forth.

Senator HARKIN. You have contracts, TWA has code-sharing contracts with carriers; right?

Mr. MORRISON. That's correct.

Senator HARKIN. In those contracts you do not require that airline to do certain things in terms of sharing—of having that code-sharing?

Mr. MORRISON. There are certain things that we do require. For example, we in some cases require the airplane to be painted in our colors. We work together in terms of scheduling philosphies so that their schedules integrate with our schedules, because obviously that's the purpose of the marketing agreement, is to be able to feed each other.

Senator HARKIN. Do the small airlines have any input as to the markets they want to serve?

Mr. MORRISON. Oh, absolutely. We are constantly meeting with our commuter friends to determine which markets they feel that they have a potential of serving, and we determine whether or not that fits into our overall marketing scheme. So the interplay between the commuter carriers and our company is ongoing. We have people assigned full time to that responsibility.

Senator HARKIN. Who makes the final decision though, you or the commuter?

Mr. MORRISON. In terms of which cities they serve?

Senator HARKIN. Yes.

Mr. MORRISON. I think it has to be a joint decision. I'm not sure that if we went to a commuter carrier and he—that particular carrier was not interested in serving a given market, I doubt if he would serve the market. I think it is a joint decision that is made.

Senator HARKIN. Obviously to the small commuter, if they lost the code sharing contract it would be devastating to them. So that does give the major airline quite a bit of economic clout over that small airline. Obviously just the mere threat they may take away that code-sharing would be economically devastating to them, on the one hand.

On the other hand, if you have a code-sharing agreement within an airline and another one came along and said—a small airline said, "Gee, I can compete, I can serve these cities and maybe a couple more, and I can give better service and better fares," but if they can't get the code-sharing, then they are out.

Mr. MORRISON. Senator, let me give you an example. I'm not sure this will answer the question, but just recently we began a code-sharing arrangement with one of our commuters to provide St. Louis/South Bend, IN, service, nonstop. Now, the market forces in South Bend are such that there are other ways that the traffic has been moving out of that particular market.

When we talked with the commuter about the possibility of providing direct service, the market was not large enough to provide jet service directly to St. Louis. I doubt seriously whether there was any way that the commuter would have provided service directly on their own, because the local market between South Bend and St. Louis is so small that it is inconceivable that they would make a profit.

So for them to go to South Bend, paint their airplane, to provide a dual designator from South Bend to St. Louis, was really in the best interest of both the commuter and Trans World Airlines. And I think that generally speaking that should be the case throughout the Country where code-sharing exists.

Senator HARKIN. Mr. Morrison, that brings up an interesting point. I talked to you before this meeting about Ozark. Now, Ozark has merged with TWA. Does TWA provide the same service to the cities and the same cities in the State of Iowa as Ozark did?

Mr. MORRISON. At the time of the merger, the end of October, the answer is yes, we provide the same level of service, but in most cases more. And I appreciate the opportunity to respond to that. Because since the merger of Ozark into Trans World Airlines, we now have six nonstops a day from Des Moines to St. Louis. Cedar

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Rapids has seven flights a day from Cedar Rapids to St. Louis, four of which are nonstop. Waterloo has five nonstops to St. Louis, where they had three before and they were not nonstop. Now, granted, in Waterloo's case we do provide two of the flights with jets and three flights with our commuter friend, which provides turboprop service down there. But the frequency out of those cities have actually increased and not decreased.

In terms of Sioux City, which is the other Iowa point that we serve, the service level is the same. We provide three one-stop flights a day. But we have also opened up the capability providing additional service to the State of Iowa, to the Iowa passengers, because of the ability to feed in St. Louis to a much larger network than what Ozark was able to feed in the past.

For example, in the past, if we operated a trip out of Waterloo to St. Louis, we were only able to connect to roughly about 50 cities directly, because that was all that Ozark served out of St. Louis. Today those flights out of Waterloo that are feeding into St. Louis are feeding 100 domestic destination and over 22 international destination.

Senator HARKIN. Let me ask you, does TWA serve the same number of cities in Iowa as it did before?

Mr. MORRISON. That's correct.

Senator HARKIN. Do you still serve Mason City?

Mr. MORRISON. No, sir. We discontinued Mason City long ago as Ozark when it reached a point where it was no longer economically feasible for us to serve those cities.

Senator HARKIN. How about Dubuque?

Mr. MORRISON. We actually served all of the cities that had commercial air service in the state of Iowa at one time. But none of those cities have received Ozark service, those smaller communities have received air service from Ozark since about 1979, when we basically withdrew from the very small cities, as subsidy was changed under 4——

Senator HARKIN. Since deregulation.

Mr. MORRISON. That's right. Under 406 it was changed to 419, and Ozark withdrew their service from basically the small communities.

Senator HARKIN. My point of reference is not when TWA took over, necessarily, Ozark, but I'm talking about from that point of deregulation on Ozark did serve cities like Fort Dodge, Mason City, Dubuque, and those cities, and then all of a sudden—and as I said, and they were making money at that time. Ozark wasn't having any problems, as I remember, they seemed to be making money at that time.

Mr. MORRISON. Well, Senator, we did have a chance to discuss that earlier, but I believe the record will show that the profit that we produced prior to the merger, 95 percent or so thereabouts, and I'm hipshooting, was made after deregulation and after the departure of the smaller communities, because basically we were a break-even airline prior to deregulation. If it had not been for the very large subsidy payment that we received to serve those small communities, we would have had a tremendous loss. The best year that we had in Ozark's history was 1981 when we made roughly $14 million.

Senator HARKIN. What was the subsidy before deregulation? What was the subsidy?

Mr. MORRISON. The total amount?

Senator HARKIN. How did it come in? I mean, what was the subsidy? It wasn't a direct Government payment, was it?

Mr. MORRISON. Yes, it was. We were paid under Section 406 subsidy that provided—we were provided generally speaking a—two round trips to one or more destinations, major hubs. Quite frankly, I think it was very uneconomical because it was not based on level of service by any means, it was based on just frequency into a particular market. And as the carriers like Ozark continue to grow and go to larger equipment, I believe it was frankly inefficient.

Senator, if I may, since I've answered the other questions, I would like to also point out I've heard several comments this morning about fare structures in Iowa in general. And I think that regardless of what marketplace you picked you would find many discrepancies, particularly where you are talking about one or two passengers per day, maybe, to that destination. Because again, the fare structures are primarily based on marketplace dictating. Out of Waterloo, for example, and again, I cannot comment on Dubuque because we don't serve Dubuque, but if you look at the fare structures out of Waterloo, I'm sure you are going to find some discrepancies. But you will find those same discrepancies whether you are in Des Moines or other major cities in the United States.

I just out of curiosity had our people in New York do an evaluation, for example, out of Waterloo, before I came up here. And I found that, for example, Waterloo/Los Angeles, which is a major market, that the Waterloo/Los Angeles walk-up fare, the Y level fare which other testimony has indicated people really don't use because everybody primarily is flying on a discount of some sort, but if you take the unrestricted, the lowest walk-up fare that's available, that fare has gone up 69 percent in 10 years. The Waterloo—excuse me, the St. Louis/Los Angeles, which is extremely competitive, always has been, has gone up 95 percent.

If you make the same comparisons in terms of discount fares, from Waterloo to Los Angeles on a discount basis you will find that Waterloo/Los Angeles has actually gone down on a discounted basis, the lowest discount fare that's available to market. That fare is actually 4 percent less than it was ten years ago, where St. Louis has actually remain the same, St. Louis/Los Angeles.

Senator HARKIN. Well, again, I understand that. Getting on with this discounted basis, obviously for the casual passenger, the person who is going on vacation, says here is the time, I will need 3 months in advance, but again, we are focusing on the impact on business and economic activity in these small communities and what that means in terms of the increases. Can I just ask one question, Mr. Mann, in your testimony you said that 90 percent of the 415 million passengers carried last year utilized some form of discount air fares.

Mr. MANN. Yes, sir.

Senator HARKIN. If 90 percent are utilizing discount air fares, then you could almost say that's the norm, and there are 10 percent that are paying——

Mr. MANN. I would say that is the norm. I want to make an——

Senator HARKIN. It's not a discount fare, that's the average. That's the normal fare. There are 10 percent who are paying through the nose.

Mr. MANN. I would like to make an observation. I am somewhat familiar with the travel agent industry myself, since my wife and I own one. We have 75 percent of our business—or 75 percent of our activity is business. And we do not sell more than probably 10 percent Y fare. There are all kinds of fares. You can get B's, M's, H's, V's, Q, 3, 5, and there are so many kinds of them. So there is just a whole random bunch that you pick up. But we do sell—like I say, a number of our business fares, and they are not all the Y fares. Very few percent of them are the Y fares. You can normally get now one—at least one notch below that to the discount. So I think that the 90 percent or so is a very good number.

Senator HARKIN. Well, again, I guess it's a way of looking at it. Again, I came across another thing dealing with some manufactured articles, where the manufacturer was making an article, it happened to be an article of clothing, where on the price tag the manufacturer had the price that they put it out for, the discount price.

Mr. MANN. Suggested retail is this, but it's this.

Senator HARKIN. You wonder is it really on sale or not, you see. And that's the way this 90 percent discount is, you wonder—I think maybe you look at it and say that's the normal price, but there are 10 percent of the passengers who are paying a lot more than that.

Mr. MANN. Maybe there should be a different way of measuring it then.

Senator HARKIN. Well, I don't know. One thing I really agree with you on is what airlines have really become since deregulation, a form of mass transportation, no doubt about it. And your figures, I assume they are correct, have almost doubled in the last 10 years. But it seems to me that what we have is a mass transportation system using trolley technology.

I've been flying for 25 years, myself. I've flown in and out of probably every major airport myself in general aviation aircraft, or military aircraft, and continue to fly today. And I served for 10 years on the Science and Technology Committee in the House where we were dealing with the R&D aspect of air travel. And I think you are absolutely right. We have this tremendous surge in air travel, and we are using the same kind of systems that we used 15, 20 years ago.

Mr. MANN. 1960 technology.

Senator HARKIN. Exactly. Just the landing, systems, for example, we are still putting in ILS systems. And I don't know how you feel about MLS, but I was a big promoter of MLS, and that's one way in congested areas to increase the traffic flow as it comes in and out of airports. I don't know what has happened. It has been held up. Microwave Landing Systems.

Of course, we know the controllers are trying to get the new computer systems in. But we are dragging our feet in that area because we aren't using the money that's in the trust fund, and I know we share that also, that the trust fund money ought to be used for what it was intended.

Mr. MANN. We need more controllers, and we can't wait for normal attrition. They should be hired now, trained, in place, with seasoning. And I think we are on the record in Congress with that.

Senator HARKIN. That all needs to be handled and that's sort of beyond our purview, although I'm glad to work with you in my other role as a Senator to try to get that moving. Again, we are looking at the impact of air fare in the small communities, and economic activity and business concerns in these communities.

I'm just absolutely convinced from talking to many people in the State of Iowa and other States that it has a detrimental effect on business activity. And it puts us at a very bad disadvantage with other areas.

Now, again, I just want to ask you another question, you said, just to get it cleared up, you said that air service in Iowa has increased 9 percent in terms of air operation since the Deregulation Act. In yesterday's "Sunday Register", an article there, there was a little graph, you might want to take a look at it, I don't know if you saw it yesterday, but it shows the airline passenger boardings percent changed from 1978 to 1986.

And I don't know how—looking at this, how does this square with what you say increased approximately 9 percent? Here it shows it's just plummeted. I just am trying to figure out—maybe we are talking about two different things. I don't know.

Mr. MANN. We drew on the Department of Transportation data.

Senator HARKIN. That's what this is. This is also DOT. It says here, DOT airport managers. Well, I don't know how they can say that. Well, I'll ask them when they come up here. I just thought maybe you had a different way——

Mr. Voss. Does that happen to be passenger information?

Senator HARKIN. This right here?

Mr. Voss. Is that the number of passengers?

Senator HARKIN. Airline passenger boardings.

Mr. Voss. I think the other side of it that has been used is operations. It's relative to the number of flights scheduled.

Mr. MANN. Frequencies of schedules have increased 9 percent. The boardings may have, in fact, gone down.

Mr. Voss. Yeah, we have got more airplanes, but smaller airlines.

Senator HARKIN. Mr. Mann, we expect and want airline companies to make a profit just like other businesses, so we expect passenger fares to be priced at levels which will allow the company to make some return on their investment. A couple of questions. How closely do current airline fare structures relate to the costs of operating the planes and running the business? For instance, many major airlines offer these discounted fares for a number of passengers on certain flights. In addition, fares are generally lower for passengers traveling from one large city or hub to another large city, and higher for passengers flying to and from the small communities. Are these fares matched with the cost of operation? Or getting back to what I had asked, I think, Mr. Frommelt earlier, are small town passengers essentially subsidizing big city travelers?

Mr. MANN. This is beyond my scope of responsibility, Senator, but I will relay the question to our Washington office and ask them to get back to you.

Senator HARKIN. Would you, please? I will leave the record open just to get this, and I will give you this question in writing.

Mr. MANN. Will you, please? That will be great.

Senator HARKIN. Because again, that's something we want looked at. Again, another specific fare you heard me mention, can you explain why a business passenger is charged $220 to fly from Des Moines to O'Hare, yet the same airline charges a smaller amount to fly that passenger through Chicago to Washington, DC?

Mr. MANN. May I ask for the question in writing?

Senator HARKIN. Sure.

Mr. MANN. I would appreciate it.

Senator HARKIN. These are answers I want to get for the record. And I just throw in there, that I wonder if the reason for the $220 price is that the two airlines serving that route see no reason to reduce it when the other airline is not going to reduce theirs, you see, if you have those two.[1]

Mr. Voss, will you share with us the experience in which your company was recently involved with Republic Airlines? I believe Great Lakes had been serving Mason City until Republic essentially pushed you out of that route. Is that correct?

Mr. Voss. Your question relates to the termination of our service on January 1 at Mason City. Prior to that we originally commenced service at Mason City in September of 1985. At that point we had, from a competitive standpoint, the carrier Northwest Air Link, Mesaba Airlines, operating with two round trips to Minneapolis/St. Paul. In May of 1986—and they were doing this with—I think it was in excess of $400,000 a year of subsidy. And so we in effect initiated service without subsidy to Chicago when the carrier was receiving service for two round trips to Minneapolis.

In May of 1986 for whatever reason it was, Republic Airlines made the decision to use its air link or its express partner to commence service, and they began offering four round trips to Minneapolis competitively with both ourself and with Mesaba. Mesaba Northwest Air Link operated 2 weeks and then discontinued the service. They made this entry into this market unsubsidized, by the way.

Well, we continued to compete up and through—in August and September we began to see a dramatic decrease in our boardings. We found that relative to several things, competitively Republic was—they offered a lower fare over Minneapolis than we were offering on a direct basis. We attempted to make some adjustments to that, but—to a certain extent it did improve in October and November, but it never did regain the portion of traffic. The convenience of the frequency became the big deciding issue in that particular market. Given the slot restraints at O'Hare, we couldn't add the additional frequency, and then we were also trying to obtain a marketing agreement, which we were unable to do. So we were losing money serving that particular market.

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[1] Material not available at time of going to press

We held our own, or maintained the service for several reasons. Due to the merger it was unclear as to what would be the end result of Republic's expressed intentions on serving the market. After the merger it was obvious they were going to stay in. And at that point we decided that we could not afford to continue serving the port and we discontinued service on January 1.

Senator HARKIN. One last thing, Mr. Mann. You wanted to do away with all slot restrictions at O'Hare and elsewhere. I guess my question is, what are you replacing them with, or are you just saying that they just are not even necessary? Mr. Voss has said if you don't have slots or if you give them to the communities, you will have 200 or 300 people all wanting to get there at the same time.

Mr. MANN. We have been with these slots now for a number of years, and they were intended to be an interim device that would be put into effect until the system, both the airport and air space systems, were developed to handle the aircraft that desired to fly there. We have obviously changed our method of operations, the industry has since deregulation, and, of course, since the end of the controller strike in 1981. We do not desire to fly up to an airport with 45 airplanes. We recognize we can only get 15 of them on the ground, and sit there and hold for an hour. That's the past.

But we do think that there is more capacity at O'Hare and there clearly will be more once the billion five hundred million plus program of the airport improvement is done at O'Hare. And we would like to see the system developed so that it would be compatible with the capacity of a number of these airports.

Clearly, we don't believe that the system is capable of even handling the demand—or the traffic that can be generated by the Chicago-O'Hare Airport. So we have got the system to be fixed. And that's why we say that we think they should be done away with. But in order to do that, of course, you have to have the infrastructure capable of handling it.

Senator HARKIN. You would have to do that. What do you mean? Are you saying that you really couldn't do away with the slots right now?

Mr. MANN. Well, from a practical standpoint I don't think we can immediately, no, but we would like to see the necessary funds expended to improve the system.

Senator HARKIN. So you could do away with it?

Mr. MANN. Right.

Senator HARKIN. I see. Counsel just handed me note that says what about D.C. National, there is no more capacity there. I guess that's a special case, perhaps.

Mr. MANN. Right.

Senator HARKIN. D.C. National is a very special case. Any other comments?

Mr. MORRISON. Senator, I would just say one other thing to you, that we have continued, and I can't speak for obviously Dubuque, because we don't serve Dubuque, but for the other four Iowa airports that we do serve, I can assure you, as I have assured the communities, we will talk with them, meet with them, work with them in terms of fares. There are discrepancies out there. We have a continued dialogue with Waterloo over the fares. And recently I re-

ceived a letter from the Airport Commission indicating that they were pleased with our response to their questions on certain fare levels. We will continue to do that. We feel Iowa is a very important part of Trans World Airlines as it was with Ozark, and we will continue to do what we can to improve that service level.

Senator HARKIN. Thank you very much. Thank you all. Our last panel is Mr. Vance Fort, Deputy Assistant Secretary for Policy and International Affairs with the Department of Transportation. I understand he is accompanied by Mr. John Coleman, Director of Essential Air Service of the Department of Transportation.

Mr. Fort, welcome to the Subcommittee, Mr. Coleman. I have a copy of your statement. It's quite lengthy. Without objection it will be made a part of the record in its entirety, and I would ask you to briefly summarize the testimony since I have read it thoroughly, I have gone through it, and I will be more interested in having a discussion with you. So if you could just basically summarize it and if you have anything you want to add, Mr. Coleman, just add it on to his testimony. Mr. Fort, welcome. Thank you for coming, I know, a great distance. I hope you didn't have any trouble getting here. Please proceed.

Mr. FORT. I had no trouble.

STATEMENT OF VANCE FORT, DEPUTY ASSISTANT SECRETARY, POLICY AND INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF TRANSPORTATION, ACCOMPANIED BY JOHN COLEMAN, DIRECTOR OF ESSENTIAL AIR SERVICE, U.S. DEPARTMENT OF TRANSPORTATION

Mr. FORT. Thank you very much, Senator. My colleague Mr. Coleman, however, was delayed considerably in getting here. We appreciate having this opportunity to appear before you today to consider the effects of airline deregulation on service to small- and medium-size communities and small businesses. This certainly is a critical consideration in any evaluation of deregulation. I might also add that we particularly appreciate the opportunity to interface and interact with communities. It's very difficult in Washington sometimes to feel the pulse of real America. So we benefit considerably by just being here and hearing testimony such as has been presented today. So in that sense, it's also very good for us. In the interests of time, let me summarize what you correctly characterized as a rather lengthy statement.

Since the aviation industry is made up of a complex system of relationships, I propose to begin with a quick look at the big picture. As you know, aviation operations were deregulated in 1978; and the changes brought about in this economic policy shape today's market. The general traveling public has benefited enormously, I feel, from the range of price and service options spurred by deregulation.

A Brookings Institution study estimates that this policy has provided the consumer with $6 billion annually in lower costs and more frequent flights.

Most important, Mr. Chairman, competition has been enlivened by deregulation. In fact, competition in the industry today is more dynamic and diverse in its many elements than ever before. Deliv-

ering what the consumer wants, including on-line services, has led to the development of business affiliation between major and regional carriers, and this phenomena is reshaping small community air service.

There has been a lot of testimony today about code sharing relationships, business affiliate relationships, and today 45 of the 50 largest regional air carriers, which collectively fly more than 80 percent of the passengers carried by regional operators, have entered into marketing alliances with one or more large jet operators.

As in the more traveled markets, competition in the regional markets is also very lively. Those regionals affiliated with the different majors can and do compete directly with each other in some markets, and very often compete indirectly with each other by serving alternative hub airports. All of this provides the traveling, shipping public with more price and service options.

The bottom line, Mr. Chairman, is that our industry today is much more competitive and we intend to keep it that way. You've also indicated an interest in our merger responsibilities. Section 408 of the Federal Aviation Act requires the Department to approve an acquisition that: One, will not result in a monopoly or further an attempted monopoly and that will not likely lessen competition substantially in any region of the United States, and, two, that is not inconsistent with the public interest. With very limited exception, Section 408 of the Act requires the Department to disapprove transactions that do not satisfy these standards. Accordingly, the primary focus of our inquiry and to each merger case is, as Congress intended, on the competitive consequences of the transaction.

It is against this background that the Department carefully examines the degree to which other carriers can freely and effectively enter the markets and that the markets will be served after the merger is completed. We review the applicants' national market share and consider whether there are significant barriers to entry at the airports which they serve. And where freedom to enter a market is not unduly restrained and can be relied upon to maintain the consumer benefits afforded, the Department has found mergers to be consistent with the applicable statutory requirements and we have approved them.

In this regard, industry competition spurred by deregulation has prompted a decline in fares to all markets, and markets of all sizes. While the decline in real fares has been more pronounced in major markets, we have heard a lot of testimony on this today, it is also the case that such a decline has in the smaller markets as well. The more modest fare reduction in the smaller markets, however, is not surprising. Traditionally, passengers traveling in low density markets have had fewer fare service options available to them. With a smaller base of consumers, it stands to reason that operating costs will be higher, service less frequent, and the fare structure tighter. Today's market simply reflects economic reality.

On a broader level, potential community benefits from the availability of scheduled air service fall into two categories: Increases in employment and earnings within the local area that result from the airline's expenditures, and the more elusive economic development benefits induced by the presence of scheduled air service.

Employment and earning benefits are apt to be quite small in nonhub communities, however. A DOT study which has been referred to by you earlier has found that the development benefits, including the often-cited claims of benefits accruing from the increased attractiveness to businesses of a community receiving scheduled air service, are extremely difficult to quantify.

Mr. Chairman, another issue of importance to your considerations today concerns Federal oversight and control regarding the distribution of landing slots at the four airports, Chicago-O'Hare, Washington National, Kennedy, and LaGuardia. The buy/sell rule, which it is called, as you know, guides activity on slot allocation. It contains basic provisions to protect service to smaller communities.

The most important of these is the designation of a portion of the total commercial aviation slots at each of these high density airports for use by commuter aircraft. This ensures that some segment of the capacity of the airports is utilized for service to smaller communities, because those are the routes for which the use of commuter aircraft is economically feasible.

The second provision in the rule for the protection of service to smaller communities is the authority to withdraw slots for Essential Air Service when it is determined by the Department that provision of Essential Air Service using these airports is necessary. In addition, the rule allows communities themselves to purchase or lease slots which they may then make available to carriers that would provide service to the cities.

Mr. Chairman, on the other side of the coin, of course, it goes without saying that the policy of deregulation has had unsettling effects on the industry. An economic sector shackled by 40 years of strict Federal regulation is bound to experience some problems as it exercises new freedoms and stretches to meet new challenges.

But, deregulation was never intended as a safe, secure policy. Economic regulatory reform opens up opportunities and allows for risk. That, in turn, begets growth and innovation. But as we tally up the pluses and minuses of this policy, a policy that is still in a state of evolution, we believe the pluses far outweigh the minuses. And these pluses include progress for small- and medium-sized communities.

Again, Mr. Chairman, thank you for asking me to testify, and I'll be happy to answer any questions.

Senator HARKIN. Thank you very much, Mr. Fort. Mr. Coleman, did you have anything to add on Essential Air Service?

Mr. COLEMAN. No, sir, I don't have any comments, but I will be more than happy to answer any questions that you have.

[The prepared statement of Mr. Fort follows:]

TESTIMONY OF VANCE FORT
DEPUTY ASSISTANT SECRETARY FOR POLICY AND INTERNATIONAL AFFAIRS
U.S. DEPARTMENT OF TRANSPORTATION
BEFORE THE COMPETITION AND ANTITRUST ENFORCEMENT SUBCOMMITTEE
SENATE COMMITTEE ON SMALL BUSINESS
JUNE 1, 1987

MR. CHAIRMAN, MEMBERS OF THE SUBCOMMITTEE, I APPRECIATE HAVING THIS OPPORTUNITY TO APPEAR TODAY AS YOU CONSIDER THE EFFECT OF AIRLINE DEREGULATION ON SERVICE TO SMALL AND MEDIUM-SIZE COMMUNITIES AND SMALL BUSINESSES. THIS CERTAINLY IS A CRITICAL CONSIDERATION IN ANY EVALUATION OF DEREGULATION. HOWEVER, SINCE THE AVIATION INDUSTRY IS MADE UP OF A COMPLEX SYSTEM OF RELATIONSHIPS, I PROPOSE WE BEGIN WITH A QUICK LOOK AT THE BIG PICTURE.

AS YOU KNOW, AVIATION OPERATIONS WERE DEREGULATED IN 1978 AND THE CHANGES BROUGHT BY THIS ECONOMIC POLICY SHAPE TODAY'S MARKET. REGULATORY REFORM OF THE AIRLINE INDUSTRY CONSTITUTES ONE OF THE MOST IMPORTANT AND SUCCESSFUL FEDERAL POLICY INITIATIVES OF THE PAST GENERATION. THE GENERAL TRAVELING PUBLIC HAS BENEFITED ENORMOUSLY FROM THE RANGE OF PRICE AND SERVICE OPTIONS SPURRED BY DEREGULATION. A BROOKINGS INSTITUTION STUDY ESTIMATES THAT THIS POLICY HAS PROVIDED THE CONSUMER WITH $6 BILLION ANNUALLY IN LOWER COSTS AND MORE FREQUENT FLIGHTS. AIR CARRIERS ENJOY THE ENHANCED ABILITY TO ADJUST PRICE AND SERVICE OFFERINGS IN RESPONSE TO CHANGING ECONOMIC CONDITIONS AND CONSUMER PREFERENCE. FURTHERMORE, AN ARTICLE IN DUN'S BUSINESS MONTHLY NOTES THAT THE ECONOMY HAS PROSPERED DUE TO THE REFORMS OF DEREGULATION. "IN AVIATION ALONE," THE ARTICLE SAYS, "DEREGULATION HAS INCREASED THE

NATION'S GROSS NATIONAL PRODUCT BY $8 BILLION IN 1977 DOLLARS ... THAT EQUALS A PERMANENT 0.4 PERCENT INCREASE IN GNP."

LET'S CONSIDER A FEW OTHER KEY DEVELOPMENTS IN THE INDUSTRY SINCE ENACTMENT OF THE AIRLINE DEREGULATION ACT:

* IN OCTOBER 1978, 34 CERTIFICATED AIRLINES PROVIDED SCHEDULED PASSENGER SERVICE, THREE PROVIDED SCHEDULED ALL CARGO SERVICE AND EIGHT PROVIDED CHARTER SERVICES. TODAY, 125 CERTIFICATED AIRLINES ARE OPERATING.

* BETWEEN OCTOBER 1978 AND OCTOBER 1986, SCHEDULED REVENUE PASSENGER-MILES INCREASED 63 PERCENT (FROM 222 BILLION TO 361 BILLION ANNUALLY). PASSENGER ENPLANEMENTS INCREASED 53 PERCENT (FROM 269 MILLION TO 413 MILLION ANNUALLY).

* SCHEDULED AVAILABLE SEAT-MILES HAVE INCREASED 66 PERCENT SINCE 1978.

* IN OCTOBER 1978, THE INDUSTRY WORK FORCE TOTALED 341,315 FULL-TIME AND PART-TIME EMPLOYEES. BY OCTOBER 1986, EMPLOYMENT HAD INCREASED TO 444,866.

* ALSO, THE NUMBER OF COMPETITIVE MARKETS JUMPED FROM 1,126 TO 1,834 BETWEEN FEBRUARY 1978 AND FEBRUARY 1987.

MOST IMPORTANT, MR. CHAIRMAN, COMPETITION HAS BEEN ENLIVENED BY DEREGULATION. IN FACT, COMPETITION IN THE INDUSTRY TODAY IS MORE DYNAMIC AND DIVERSE IN ITS MANY ELEMENTS THAN EVER BEFORE. WE MUST RECOGNIZE THAT CHANGING INDUSTRY OPERATING PRACTICES AND MARKETING STRATEGIES ARE WORKING TO RESHAPE THE STRUCTURE AND BUSINESS PRACTICES OF THE AIRLINE INDUSTRY RESULTING IN GREATER COMPETITION WHICH BENEFITS THE CONSUMER.

DELIVERING WHAT THE CONSUMER WANTS--INCLUDING ON-LINE SERVICES--HAS LED TO THE DEVELOPMENT OF BUSINESS AFFILIATIONS BETWEEN MAJOR AND REGIONAL CARRIERS, AND THIS PHENOMENON IS RESHAPING SMALL COMMUNITY AIR SERVICE. TODAY, 45 OF THE 50 LARGEST REGIONAL AIR CARRIERS -- WHICH COLLECTIVELY FLY MORE THAN 80 PERCENT OF THE PASSENGERS CARRIED BY REGIONAL OPERATORS -- HAVE ENTERED INTO MARKETING ALLIANCES WITH ONE OR MORE LARGE JET OPERATORS. ALLIANCES BETWEEN MAJOR AND REGIONAL CARRIERS CAN PROVIDE THE TRAVELING PUBLIC WITH SUBSTANTIAL BENEFITS, INCLUDING INTEGRATION OF SCHEDULES, COOPERATIVE MARKETING AND PROMOTIONAL ARRANGEMENTS, PARTICIPATION BY THE REGIONALS IN THE MAJORS' FREQUENT FLYER PROGRAMS, AND ADDITIONAL ADMINISTRATIVE AND SUPPORT SERVICES. SOME MAJOR CARRIERS EVEN PROVIDE THEIR REGIONAL PARTNERS WITH FINANCIAL ASSISTANCE. AMERICAN AIRLINES, FOR EXAMPLE, HAS A $100,000,000 AIRCRAFT LEASING PROGRAM FOR REGIONAL CARRIERS AND RECENTLY EXTENDED $27,000,000 TO AN AMERICAN EAGLE COMMUTER.

AND, AS IN THE MORE HEAVILY TRAVELED MARKETS, COMPETITION IN THIS SECTOR OF THE INDUSTRY IS LIVELY. THOSE REGIONALS AFFILIATED WITH DIFFERENT MAJORS CAN AND DO COMPETE DIRECTLY WITH EACH OTHER IN SOME MARKETS; AND REGIONALS OFTEN COMPETE INDIRECTLY WITH ONE ANOTHER BY SERVING ALTERNATIVE HUB AIRPORTS, THUS PROVIDING TRAVELERS WITH MORE PRICE AND SERVICE OPTIONS. WHILE COMPETITION IN THE REGIONAL AIRLINE INDUSTRY REMAINS VIGOROUS, IT MAY BE DIFFICULT FOR A NON-AFFILIATED REGIONAL TO COMPETE AGAINST AN AFFILIATED REGIONAL CARRIER.

THE BOTTOM LINE IS THAT OUR AIRLINE INDUSTRY IS COMPETITIVE TODAY, AND WE INTEND TO KEEP IT THAT WAY. IN THAT REGARD, MR. CHAIRMAN, THE SUBCOMMITTEE EXPRESSED AN INTEREST IN THE DEPARTMENT'S MERGER POLICY. ACCORDINGLY, I WOULD NOW LIKE TO FOCUS ATTENTION ON CONSOLIDATIONS AND OUR LEGAL APPROACH TO CONSIDERING MERGERS AND ACQUISITIONS.

AS YOU KNOW, THE DEPARTMENT OF TRANSPORTATION HAS REVIEWED A NUMBER OF MERGERS AND ACQUISITIONS DURING THIS PAST YEAR. DURING OUR CONSIDERATION PROCESS WE HAVE ACTED WITHIN THE GUIDELINES SET BY CONGRESS UPON PASSAGE OF THE AIRLINE DEREGULATION ACT. SECTION 408 OF THE FEDERAL AVIATION ACT OF 1958 GOVERNS AIRLINE MERGERS AND ACQUISITIONS. THAT SECTION REQUIRES THE DEPARTMENT'S PRIOR APPROVAL FOR THE ACQUISITION OF CONTROL OF ONE AIR CARRIER BY ANOTHER CARRIER OR PERSON CONTROLLING ANOTHER CARRIER.

TODAY, SECTION 408 EMBODIES ANTITRUST STANDARDS TRADITIONALLY APPLIED BY THE COURTS TO UNREGULATED INDUSTRIES. BUT, THIS WAS NOT ALWAYS THE CASE. IN FACT, PRIOR TO 1978, THIS SECTION CONFERRED BROAD DISCRETION ON THE CIVIL AERONAUTICS BOARD (CAB) TO APPROVE OR DISAPPROVE AIRLINE MERGERS AND ACQUISITIONS UNDER A "PUBLIC INTEREST" TEST. HISTORY SHOWS THAT THERE WERE TIMES WHEN THE CAB USED THIS AUTHORITY TO DISAPPROVE MERGERS, NOT BECAUSE THEY HARMED COMPETITION PER SE, BUT RATHER BECAUSE THEY COULD TEAR THE FABRIC OF THE HIGHLY STRUCTURED--ALTHOUGH INEFFICIENT--ROUTE NETWORK THAT THE BOARD HAD CREATED OVER TIME.

THAT THE CAB SHOULD HAVE APPLIED SECTION 408 IN THIS FASHION IS NOT SURPRISING SINCE THAT SECTION WAS AN INTEGRAL PART OF A THEN INTENSELY REGULATED REGIME WHICH VALUED PROTECTION AND GOVERNMENTAL INTERVENTION OVER COMPETITION AND MARKET-ORIENTED DECISIONMAKING.

WHEN IT BECAME EVIDENT BY THE MID-TO-LATE SEVENTIES THAT THE AVIATION INDUSTRY COULD OPERATE MORE EFFECTIVELY AND EFFICIENTLY WITHOUT THE CONSTRAINTS OF FEDERAL ECONOMIC REGULATIONS, CONGRESS RESPONDED BY ENACTING THE AIRLINE DEREGULATION ACT. THIS LEGISLATION AMENDED THE FEDERAL AVIATION ACT AND BROUGHT THE LAW GOVERNING AIRLINES CLOSER TO LAWS GOVERNING NON-REGULATED INDUSTRIES.

CONGRESS INDICATED THAT SECTION 408 MUST BE ADMINISTERED CONSISTENT WITH ITS INTENT TO MOVE THE INDUSTRY RAPIDLY TOWARD

DEREGULATION. THE CONFERENCE REPORT TO THE DEREGULATION ACT, IN EXPLAINING THE CHANGES TO SECTION 408, STATED CLEARLY THAT, "THE FOUNDATION OF THE NEW AIRLINE LEGISLATION IS THAT IT IS IN THE PUBLIC INTEREST TO ALLOW THE AIRLINE INDUSTRY TO BE GOVERNED BY THE FORCES OF THE MARKETPLACE."

ACCORDINGLY, SECTION 408 NOW REQUIRES THE DEPARTMENT TO APPROVE AN ACQUISITION (1) THAT WILL NOT RESULT IN A MONOPOLY OR FURTHER AN ATTEMPTED MONOPOLY AND THAT WILL NOT LIKELY LESSEN COMPETITION SUBSTANTIALLY IN ANY REGION OF THE UNITED STATES, AND (2) THAT IS NOT INCONSISTENT WITH THE PUBLIC INTEREST. SECTION 408 REQUIRES THE DEPARTMENT TO DISAPPROVE TRANSACTIONS THAT DO NOT SATISFY THESE STANDARDS, UNLESS THE DEPARTMENT FINDS THAT THEY MEET SIGNIFICANT TRANSPORTATION NEEDS AND CONVENIENCES OF THE PUBLIC THAT CANNOT BE MET THROUGH ANY REASONABLY AVAILABLE ALTERNATIVE TRANSACTION THAT WOULD BE MATERIALLY LESS ANTI-COMPETITIVE. SECTION 408 ALSO EMPOWERS THE DEPARTMENT TO IMPOSE SUCH CONDITIONS ON ITS APPROVAL AS ARE CONSIDERED JUST AND REASONABLE.

IN EXERCISING ITS RESPONSIBILITIES, THE DEPARTMENT HAS BEEN MINDFUL OF THE PROCOMPETITIVE POLICY ORIENTATION OF THE NEW SECTION 408 OF THE ACT. WE WHOLEHEARTEDLY SUPPORT CONGRESS' APPROACH AND HAVE FOLLOWED ITS DIRECTION. FOR THIS REASON, THE DEPARTMENT USUALLY HAS NOT BECOME INVOLVED IN THE DETAILS OF THE PROPOSED TRANSACTION BEYOND THAT INVOLVEMENT NECESSARY FOR A SOUND COMPETITIVE REVIEW. IT HAS SPECIFICALLY REFRAINED FROM PASSING JUDGMENT ON WHETHER THE TRANSACTION UNDER CONSIDERATION WOULD BE

PROFITABLE, AND, IF CONSISTENT WITH THE ANTITRUST LAWS, WHETHER IT WOULD DIVERT TRAFFIC FROM OTHER CARRIERS. WE STRONGLY BELIEVE THAT THE MARKETPLACE SHOULD BE THE PRINCIPAL DISCIPLINE FOR THE CARRIERS' BUSINESS DECISIONS. IT IS ALSO OUR CONVICTION THAT DOT'S PRINCIPAL ROLE IN A DEREGULATED ENVIRONMENT IS TO PROTECT THE COMPETITIVE PROCESS, NOT INDIVIDUAL COMPETITORS.

ACCORDINGLY, THE PRIMARY FOCUS OF THE DEPARTMENT'S INQUIRY IN EACH MERGER CASE IS, AS CONGRESS INTENDED, ON THE COMPETITIVE CONSEQUENCES OF THE TRANSACTION. THEREFORE, THE DEPARTMENT HAS EXAMINED THE COMPETITIVE EFFECTS OF AIRLINE MERGERS AND ACQUISITIONS UNDER THE STANDARDS ESTABLISHED BY SECTION 7 OF THE CLAYTON ACT, WHICH GOVERNS MERGERS AND ACQUISITIONS IN UNREGULATED INDUSTRIES. OUR APPROVAL OF MERGERS AND ACQUISITIONS HAS BEEN BASED ON WELL-DEVELOPED EVIDENTIARY RECORDS THAT SHOW THERE IS NO LIKELIHOOD OF A SUBSTANTIAL REDUCTION IN COMPETITION IN ANY RELEVANT MARKETS.

WITH OUR EYE ON THIS TARGET, WE RECOGNIZE THAT DEREGULATION GAVE AIRLINES THE RIGHT TO ENTER AND EXIT MARKETS WITHOUT GOVERNMENTAL SUPERVISION. THE ABILITY TO ENTER MARKETS IS ESSENTIAL TO ENSURING A COMPETITIVE AIRLINE INDUSTRY. IT PROVIDES CARRIERS WITH THE OPPORTUNITY TO CHOOSE THE MARKETS THEY WILL SERVE AND TO RESPOND TO ANY PERCEIVED DEFICIENCIES IN MARKET PERFORMANCE. THERE IS LITTLE DOUBT THAT FREEDOM OF ENTRY EXERTS CONSIDERABLE PRESSURE ON INCUMBENT CARRIERS TO PROVIDE COMPETITIVE FARES AND

SERVICES, AND THAT ENTRY BARRIERS HAVE PRECISELY THE OPPOSITE EFFECT.

IT IS AGAINST THIS BACKGROUND THAT THE DEPARTMENT CAREFULLY EXAMINES THE DEGREE TO WHICH OTHER CARRIERS CAN FREELY AND EFFECTIVELY ENTER THE MARKETS THAT WILL BE SERVED BY THE MERGED CARRIERS. IN THIS REGARD, WE REVIEW THE APPLICANTS' NATIONAL MARKET SHARE AND CONSIDER WHETHER THERE ARE SIGNIFICANT BARRIERS TO ENTRY AT THE AIRPORTS WHICH THEY SERVE. WHERE THE FREEDOM TO ENTER A MARKET IS NOT UNDULY CONSTRAINED, AND CAN BE RELIED UPON TO MAINTAIN THE CONSUMER BENEFITS AFFORDED BY MEANINGFUL COMPETITION, THE DEPARTMENT HAS FOUND MERGERS TO BE FULLY CONSISTENT WITH THE APPLICABLE STATUTORY REQUIREMENTS AND HAS APPROVED THEM. IN EXAMINING THE COMPETITIVE CONSEQUENCES OF A PROPOSED MERGER, WE HAVE FOUND VALID THE CIVIL AERONAUTICS BOARD'S PRINCIPLE THAT THE CHANGE IN THE AMOUNT OF CONCENTRATION IN INDIVIDUAL CITY-PAIR MARKETS IS USUALLY NOT A USEFUL GUIDE TO THE ACQUISITION'S COMPETITIVE EFFECTS. WE HAVE FOUND, AS DID THE BOARD, THAT CONCENTRATION STATISTICS ARE NOT ORDINARILY USEFUL SINCE MANY AIRLINE MARKETS ARE COMPETITIVE, EVEN THOUGH HIGHLY CONCENTRATED UNDER STANDARD MEASURES, BECAUSE THE EASE OF ENTRY WILL PERMIT OTHER CARRIERS TO QUICKLY BEGIN SERVING A ROUTE IF THE INCUMBENT CARRIERS CHARGE SUPRACOMPETITIVE FARES OR OPERATE A LEVEL OF SERVICE BELOW THE COMPETITIVE LEVEL. INSTEAD OF RELYING ON CONCENTRATION FIGURES, WE HAVE ENGAGED IN A FUNCTIONAL ANALYSIS THAT EXAMINES HOW AN ACQUISITION IS LIKELY TO AFFECT THE MARKETS

AT ISSUE IN LIGHT OF THE AIRLINE INDUSTRY'S ECONOMICS AND OPERATING PRACTICES.

IN THOSE INSTANCES WHERE COMPETITION MAY BE REDUCED AND THEREFORE CANNOT BE RELIED UPON TO PROTECT CONSUMERS, THE DEPARTMENT WILL DISAPPROVE THE MERGER. THE DEPARTMENT DOES NOT, HOWEVER, SPECIFY CONDITIONS, IF ANY, THAT WOULD ALLOW US TO APPROVE THE TRANSACTION. RATHER, WE IDENTIFY THE COMPETITIVE PROBLEMS THAT PRECLUDE OUR APPROVAL OF THE TRANSACTION, AND LEAVE IT TO THE PARTIES TO DEVISE A REMEDY FOR THOSE PROBLEMS. THE PARTIES THEN HAVE TO SUBMIT A REVISED PROPOSAL TO THE DEPARTMENT FOR REVIEW IF THEY CHOOSE TO PROCEED WITH THE MERGER OR ACQUISITION.

MR. CHAIRMAN, WE EVALUATE THE AIRLINE INDUSTRY'S CHANGING STRUCTURE, BEHAVIOR, AND PERFORMANCE ON A CONTINUING BASIS. DOT HAS AN ONGOING RESEARCH PROGRAM THAT IS DESIGNED TO ASSESS THE STATE OF COMPETITION IN THE INDUSTRY.
WE ARE ALSO CURRENTLY ENGAGED IN AN IN-DEPTH STUDY OF THE COMPUTER RESERVATION SYSTEMS. OUR OBJECTIVE IS TO UNDERSTAND HOW THESE SYSTEMS AFFECT COMPETITION IN THE AIRLINE INDUSTRY. SHOULD WE CONCLUDE THAT THE EXISTING RULES GOVERNING THESE SYSTEMS NEED TO BE MODIFIED TO PRESERVE COMPETITION, THE DEPARTMENT IS PREPARED TO TAKE APPROPRIATE REMEDIAL ACTION.

I HOPE IT IS OBVIOUS THAT THE AVIATION POLICY OF THE DEPARTMENT IS FOCUSED CLEARLY ON MAINTAINING AN OPEN, COMPETITIVE INDUSTRY. WE

ARE CONVINCED THAT SUCH COMPETITION FOSTERS BENEFITS IN ALL MARKETS, INCLUDING SMALL TO MEDIUM-SIZE COMMUNITIES.

IN THIS REGARD, INDUSTRY COMPETITION SPURRED BY DEREGULATION HAS PROMPTED A DECLINE IN FARES TO MARKETS OF ALL SIZES. (SEE TABLE 1.) WHILE THE DECLINE IN REAL FARES HAS BEEN MORE PRONOUNCED IN MAJOR MARKETS, SUCH AS LARGE-HUB TO LARGE-HUB ROUTES -- WHERE FARES HAVE DECLINED BY 17 PERCENT ON AVERAGE -- EVEN IN THE SMALLEST MARKETS, FARES HAVE DECLINED AN AVERAGE OF 7 PERCENT.

IN THE MAJOR MARKETS, LOW-COST CARRIERS INAUGURATED SERVICE AT FARES BELOW NORMAL COACH FARES. THEIR LOW FARES IN TURN FORCED THE HAND OF COMPETING CARRIERS. FURTHER, THE NUMBER AND DEPTH OF DISCOUNT FARES INCREASED GREATLY IN DIRECT PROPORTION TO THE SIZE OF MARKET SERVED. CONSEQUENTLY, LARGE MARKETS HAVE A WIDER RANGE OF DISCOUNT FARES THAN DO SMALL MARKETS.

THE MORE MODEST FARE REDUCTIONS IN SMALLER MARKETS ARE NOT SURPRISING. TRADITIONALLY, LOW DENSITY MARKETS HAVE HAD FEWER FARE AND SERVICE OPTIONS AVAILABLE. WITH A SMALLER BASE OF CONSUMERS, IT STANDS TO REASON THAT OPERATING COSTS WOULD BE HIGHER, SERVICE LESS FREQUENT, AND THE FARE STRUCTURE TIGHTER. TODAY'S MARKET SIMPLY REFLECTS ECONOMIC REALITY.

ALSO, SOME OF THE DIFFERENCES IN FARE CHANGES IS DUE TO THE ELIMINATION OF CROSS-SUBSIDY AMONG DIFFERENT CATEGORIES OF PASSENGERS. BEFORE DEREGULATION, CARRIERS TENDED TO OVERPRICE IN HEAVILY TRAVELED LONG-HAUL MARKETS AND UNDERPRICE IN LIGHTLY

TRAVELED MARKETS. THIS POLICY WAS THE DIRECT RESULT OF CIVIL AERONAUTICS BOARD FARE FORMULAS DESIGNED TO ENCOURAGE GROWTH IN SHORT-HAUL AND LIGHTLY TRAVELED MARKETS.

WHATEVER THE DISPARITY FOUND BETWEEN FARE STRUCTURES OF LARGE AND SMALL MARKETS, THE DIFFERENCES CAN BE JUSTIFIED BY COST ANALYSES. A RECENT STUDY 1/ CONDUCTED BY THE DEPARTMENT OF TRANSPORTATION ANALYZES THE COST OF PROVIDING SERVICE TO SMALLER MARKETS, AND UPON COMPARING THE COSTS WITH ACTUAL FARES CHARGED IN VARIOUS MARKETS, IT WAS DISCOVERED THAT THE CURRENT PRICING POLICIES OF COMMUTER CARRIERS ARE QUITE REASONABLE. (SEE TABLES 2 AND 3.)

ON A BROADER LEVEL, POTENTIAL COMMUNITY BENEFITS FROM THE AVAILABILITY OF SCHEDULED AIR SERVICE FALL INTO TWO CATEGORIES: INCREASES IN EMPLOYMENT AND EARNINGS WITHIN THE LOCAL AREA THAT RESULT FROM THE AIRLINE'S EXPENDITURES AND THE MORE ELUSIVE ECONOMIC DEVELOPMENT BENEFITS INDUCED BY THE PRESENCE OF SCHEDULED AIR SERVICE. EMPLOYMENT AND EARNINGS BENEFITS ARE APT TO BE QUITE SMALL IN NON-HUB COMMUNITIES. A DOT STUDY 2/ FOUND THAT ECONOMIC DEVELOPMENT BENEFITS, INCLUDING THE OFTEN-CITED CLAIMS OF BENEFITS ACCRUING FROM THE INCREASED ATTRACTIVENESS TO BUSINESSES OF A COMMUNITY RECEIVING SCHEDULED AIR SERVICE, ARE EXTREMELY DIFFICULT TO QUANTIFY. UPON CLOSER EXAMINATION, SUCH DEVELOPMENT BENEFIT CLAIMS APPEAR TO BE MADE FOR AIRPORTS AND GENERAL AVIATION

1/ Report to Congress on Subsidized Air Service Under the Essential Air Service Program -- Section 419 of the Federal Aviation Act, U.S. Department of Transportation, Washington, D.C., February 1987.

2/ Essential Air Service: Regional Impacts, U.S. Department of Transportation, Research and Special Programs Administration, Transportation System Center, Cambridge, Mass., December 1986.

FACILITIES RATHER THAN FOR SCHEDULED AIR SERVICE ITSELF.

SOME LIMITED EVIDENCE SUGGESTS THAT AIRPORTS AND THE TYPE OF SERVICES THEY PROVIDE MAY WELL BE CONSIDERATIONS FOR THE SITING OF CERTAIN TYPES OF BUSINESS AND INDUSTRIAL FACILITIES, BUT THERE IS NO EVIDENCE THAT THE EXISTENCE OF SCHEDULED SERVICE AT THESE AIRPORTS HAS COMPARABLE EFFECTS ON LOCATION DECISIONS. EVEN IN THESE CASES THE DESIRABILITY OF AN AIRPORT MAY PLACE WELL DOWN ON A LIST OF SITE SELECTION FACTORS, BELOW ITEMS SUCH AS PROXIMITY TO IMPORTANT MARKETS, AVAILABILITY OF RAW MATERIALS, LABOR, UTILITIES, TAX TREATMENT, AMENITIES, AND SITE SUITABILITY.

A 1970 STUDY BY LEONARD F. WHEAT FOUND THAT FOR CITIES IN THE NORTHEAST BELOW 19,000 POPULATION THERE WAS NO EVIDENCE THAT THE PRESENCE OF AIR SERVICE HAD AN IMPACT UPON MANUFACTURING EMPLOYMENT GROWTH. FOR LARGER CITIES, HE CONCLUDED THAT AIR SERVICE PROBABLY PROMOTED GROWTH, BUT FOUND THE BENEFITS TO BE "SEVERELY LIMITED." 3/

A 1975 NASA-FUNDED STUDY OF GENERAL AVIATION IMPACTS CONCLUDED THAT UNLESS OTHER FREQUENTLY MENTIONED FACTORS WERE PRESENT, IT WAS UNLIKELY THAT AVIATION FACILITIES WOULD AID IN WOOING INDUSTRY, AND IT WAS UNLIKELY THAT THE LACK OF GENERAL AVIATION SERVICES WOULD DETER AN OTHERWISE INTERESTED COMPANY. 4/

3/ Wheat, Leonard F., The Effect of Airline Service on Manufacturing Growth in Cities Below 40,000 Population, Economic Development Administration, U.S. Department of Commerce, May 1970.
4/ Dayani, J., and Sinoff, M., General Aviation and Community Development, NASA Langley Research Center and Old Dominion University, Norfolk, VA, 1975.

A STUDY OF RESPONSES TO A NEBRASKA SURVEY OF INDUSTRIAL PLANTS FOUND THAT AIR PASSENGER TRANSPORTATION RATED 36TH IN IMPORTANCE OUT OF 43 POSSIBLE FACTORS. 5/ A 1975 STUDY BY THE MINNESOTA DEPARTMENT OF AERONAUTICS FOUND AIR SERVICE ACCESSIBILITY IN THE BOTTOM HALF OF LOCATIONAL CONSIDERATIONS LISTED FOR ALL TYPES OF INDUSTRIES AND COMMUNITIES STUDIED. 6/

IN SUMMARY, A SURVEY OF THE LITERATURE INDICATES THAT INSOFAR AS THE VARIOUS BUSINESSES THAT WERE STUDIED CONSIDERED AVIATION SERVICES IMPORTANT, THEY APPEARED TO BE CONCERNED WITH ACCESS TO A GENERAL AVIATION AIRPORT, AND THE PRESENCE OF A FIXED BASE OPERATOR TO SUPPORT PRIVATE BUSINESS AIRCRAFT AND AIR-TAXI SERVICE. THE AVAILABILITY OF SCHEDULED AIR SERVICE WAS NOT HIGHLY RATED NOR, IN MOST CASES, EVEN EXPRESSED AS A FACTOR INFLUENCING BUSINESS LOCATION DECISIONS.

MR. CHAIRMAN, ANOTHER ISSUE OF IMPORTANCE TO YOUR CONSIDERATIONS TODAY CONCERNS FEDERAL OVERSIGHT AND CONTROL REGARDING THE DISTRIBUTION OF LANDING SLOTS AT FOUR AIRPORTS: CHICAGO-O'HARE, WASHINGTON-NATIONAL, KENNEDY AND LA GUARDIA. AS YOU KNOW, THE HIGH DENSITY RULE WAS IMPOSED ON THESE FACILITIES TO RELIEVE CONGESTION AND DELAYS 18 YEARS AGO. SCHEDULING COMMITTEES EVOLVED AT THE AFFECTED AIRPORTS TO ALLOCATE LIMITED SLOTS. THESE COMMITTEES -- COMPOSED OF CARRIERS SERVING THE AIRPORT AS WELL AS

5/ Whiting, Larry R., Rural Industralization: Problems and Potentials, Iowa State University Press, Ames, Iowa, 1974.
6/ A Study of the Socio-Economic Impact of Aviation on Selected Communities, Minnesota Department of Aeronautics, January 1975.

THOSE WISHING TO PROVIDE SERVICE -- ENJOYED ANTITRUST IMMUNITY AND THE SYSTEM WORKED REASONABLY WELL FOR MORE THAN A DECADE. DURING THE ERA OF AVIATION REGULATION, SCHEDULING COMMITTEES COULD DEAL EFFECTIVELY WITH CONSTRAINED SLOT CAPACITY SINCE NEW CARRIER ENTRY WAS CAREFULLY CONTROLLED BY THE CIVIL AERONAUTICS BOARD. THERE WERE FEWER PARTIES TO CARVE THE PIE AND, IN THIS SETTING, PARTICIPANTS RECOGNIZED THE VALUE OF MUTUAL ACCOMMODATION.

WITH THE ADVENT OF DEREGULATION, HOWEVER, THE SYSTEM OF ALLOCATION BY SCHEDULING COMMITTEES FLOUNDERED BADLY AND ALL BUT COLLAPSED. DEREGULATION OPENED THE DOORS FOR NEW ENTRANTS AND THEY INCREASED OPERATIONS SIGNIFICANTLY. THE PIE COULDN'T BE REBAKED TO SATISFY NEW CIRCUMSTANCES. ORDERLY SLOT ALLOCATION BY COMMITTEE BROKE DOWN. THE SYSTEM WAS FROZEN NEARLY SOLID, AND THIS AT AIRPORTS WHICH HANDLE 14 PERCENT OF ALL PASSENGER ENPLANEMENTS IN THE COUNTRY.

HENCE THERE CAME THE INSTITUTION OF THE BUY/SELL RULE LAST YEAR WHICH ALLOWS AIR CARRIERS, COMMUTERS, AND OTHER PERSONS TO BUY, SELL OR LEASE SLOTS IN ANY TIME PERIOD FOR ANY CONSIDERATION. FRANKLY, THE ADMINISTRATION CONSIDERS THE RULE A VERY POOR SUBSTITUTE FOR UNFETTERED SERVICE OPPORTUNITIES. BUY/SELL IS NOT THE IDEAL SOLUTION BUT, RATHER, A MEANS OF ADDRESSING A "REAL WORLD" PROBLEM IN AS EQUITABLE A MANNER AS POSSIBLE.

MR. CHAIRMAN, THE BUY/SELL RULE CONTAINS BASIC PROVISIONS TO PROTECT SERVICE TO SMALLER COMMUNITIES. THE MOST IMPORTANT OF THESE IS THE DESIGNATION OF A PORTION OF THE TOTAL COMMERCIAL AVIATION SLOTS AT EACH OF THE AIRPORTS FOR USE BY COMMUTER AIRCRAFT. THIS ENSURES THAT SOME SEGMENT OF THE CAPACITY OF THE AIRPORTS IS UTILIZED FOR SERVICE TO SMALLER COMMUNITIES BECAUSE THOSE ARE THE ROUTES FOR WHICH THE USE OF COMMUTER AIRCRAFT IS ECONOMICALLY FEASIBLE.

THE SECOND PROVISION IN THE RULE FOR THE PROTECTION OF SERVICE TO SMALLER COMMUNITIES IS THE AUTHORITY TO WITHDRAW SLOTS FOR ESSENTIAL AIR SERVICE USE WHEN IT IS DETERMINED BY THE DEPARTMENT THAT PROVISION OF ESSENTIAL AIR SERVICE USING THESE AIRPORTS IS NECESSARY. IN ADDITION, THE RULE ALLOWS COMMUNITIES THEMSELVES TO PURCHASE OR LEASE SLOTS WHICH THEY MAY THEN MAKE AVAILABLE TO CARRIERS THAT WOULD PROVIDE SERVICE TO THEIR CITIES.

THE OVERSIGHT BEING EXERCISED BY THE DEPARTMENT IS LIMITED, FOR THE MOST PART, TO ENSURING THAT CARRIERS ONLY OPERATE FLIGHTS FOR WHICH THEY POSSESS SLOTS. IN ADDITION, THE DEPARTMENT DOES ANALYZE DATA ON THE SLOT UTILIZATION TO ENSURE THAT THEY ARE BEING UTILIZED IN COMPLIANCE WITH THE PROVISIONS OF THE BUY/SELL RULE AND NOT STOCKPILED FOR FUTURE NEEDS OR FOR SPECULATIVE PURPOSES. TO SUGGEST THAT THE DEPARTMENT BECOME MORE DIRECTLY INVOLVED IN THE ALLOCATION OF SLOTS AMONG CARRIERS AND MARKETS WOULD REQUIRE THE DEPARTMENT TO MAKE DECISIONS THAT ARE BETTER LEFT TO THE MARKETPLACE. INDEED, IT WOULD CREATE AN ENVIRONMENT WHERE THE

DETERMINATION OF HOW THE SLOTS WERE TO BE USED WOULD BE LARGELY ARBITRARY.

WE BELIEVE THAT THE TRANSPORTATION SYSTEM AND THE ECONOMIC WELFARE OF THE NATION ARE BEST SERVED BY ALLOWING THE MARKET TO DICTATE HOW THE SLOTS WILL BE USED. IN GENERAL, THIS MARKET-BASED APPROACH WILL RESULT IN THE SLOTS BEING USED, WITHIN THE EXISTING LIMITATIONS, IN THE MOST HIGHLY VALUED MANNER, WHICH MEANS TO PROVIDE SERVICE IN THOSE MARKETS WHICH TRAVELERS FIND MOST DESIRABLE.

WE FEEL THAT THE RULE IS OPERATING SMOOTHLY; TRANSACTIONS TAKE PLACE REGULARLY AS MARKET CHANGES DICTATE. A GROWING SHARE OF THE TRANSACTIONS ARE LEASES. THIS SUGGESTS THAT THE RULE IS BEING USED TO FACILITATE SHORT-TERM SLOT SHIFTS, THEREBY ALLOWING A MORE EFFECTIVE USE OF THE LIMITED CAPACITY AT THE SLOT CONSTRAINED AIRPORTS THAN WOULD BE THE CASE IF A LESS FLEXIBLE REGULATION WERE IN EFFECT.

MR. CHAIRMAN, WITHOUT QUESTION THE POLICY OF AIRLINE DEREGULATION HAS HAD UNSETTLING EFFECTS ON THE INDUSTRY. AN ECONOMIC SECTOR SHACKLED BY FORTY YEARS OF STRICT FEDERAL REGULATION IS BOUND TO EXPERIENCE SOME PROBLEMS AS IT EXERCISES NEW FREEDOMS AND STRETCHES TO MEET NEW CHALLENGES. BUT, DEREGULATION WAS NEVER INTENDED AS A SAFE, SECURE POLICY. ECONOMIC REGULATORY REFORM OPENS OPPORTUNITIES AND ALLOWS FOR RISK. THAT, IN TURN, BEGETS GROWTH AND INNOVATION.

AS WE TALLY UP THE PLUSES AND MINUSES OF THIS POLICY -- A POLICY THAT IS STILL IN A STATE OF EVOLUTION -- WE BELIEVE THE PLUSES OUT-WEIGH THE MINUSES. AND THESE PLUSES INCLUDE PROGRESS FOR SMALL AND MEDIUM-SIZED COMMUNITIES.

AGAIN, MR. CHAIRMAN, THANK YOU FOR ASKING ME TO TESTIFY. THIS CONCLUDES MY FORMAL PRESENTATION.

Table 1

Prices in Airline Markets, by Type, 1979 and 1985

Market Type	Real Price (Cents per Mile)* 1979	1985
Large Hub-Large Hub	4.4	3.6
Large Hub-Medium Hub	4.7	4.0
Large Hub-Small Hub	4.9	4.1
Large Hub-Nonhub	5.3	4.6
Medium Hub-Medium Hub	4.9	4.1
Medium Hub-Small Hub	5.1	4.4
Medium Hub-Nonhub	5.5	5.1
Small Hub-Small Hub	5.4	4.8
Small Hub-Nonhub	5.7	5.3
Nonhub-Nonhub	6.2	5.8

* Real price is total real revenues divided by total revenue passenger miles flown. It is used here in lieu of actual dollar fares to correct for differences in trip length between the two periods.

Table 2

COMPARATIVE COST ANALYSIS
125 MILES

	Piper T-1020	Beech C-99	Metro IIIA	Shorts 360	F-27
Direct Expense 1/	$238,476	$313,286	$357,300	$495,876	$651,300
Indirect Expense 2/	178,857	219,300	250,110	322,319	423,345
Total Operating Expense	$417,333	$532,586	$607,410	$818,195	$1,074,645

1/ Assumes the following annual block hours and costs per hour:

Flying Operations	$ 75	$ 90	$ 95	$120	$130
Fuel & Oil	53	66	72	96	130
Maintenance	70	90	120	140	220
Depr. & Interest/Rentals	40	80	110	160	100
Total Directs	$238	$326	$397	$516	$650
Block Hours	1,002	961	900	961	1,002

2/ Assumes the following percentages, indirects of directs:

	75%	70%	70%	65%	65%

Table 3

TOTAL ECONOMIC COST PER PASENGER FOR VARYING
ANNUAL PASSENGER AMOUNTS BY STAGELENGTH BY AIRCRAFT TYPE

Aircraft Type/Milage	Total Economic Cost Per Passenger For Varying Annual Passenger Amounts			
	3,130 (5/day)	6,260 (10/day)	9,390 (15/day)	12,520 (20/day)
Piper T-1020				
75	$112.30	$ 74.30	$ 61.47	$ 55.00
125	139.45	94.39	79.07	71.25
200	177.85	123.06	104.46	95.00
300	229.21	162.34	139.44	127.67
Beech C-99				
75	$134.57	$ 69.57	$ 47.91	$ 47.57
125	171.06	88.34	60.77	60.86
200	224.56	115.88	79.65	81.48
300	291.15	150.23	103.25	108.30
Metro III A				
75	$146.92	$ 75.75	$ 52.02	$ 40.16
125	192.63	99.13	67.96	52.38
200	250.41	128.81	88.27	68.00
300	318.80	164.05	112.47	86.67
Shorts 360				
75	$191.13	$ 97.86	$ 66.76	$ 51.22
125	244.38	125.00	85.21	65.31
200	326.55	166.88	113.65	87.04
300	429.50	219.40	149.37	114.35
F-27				
75	$262.20	$133.38	$ 90.45	$ 68.98
125	322.47	164.05	111.24	84.84
200	417.22	212.21	143.87	109.70
300	533.75	271.52	184.12	140.41

Senator HARKIN. Mr. Fort, let me just turn to the most pressing problem at hand, then I will get to the more general ones. You were here and you heard the testimony this morning that under the orders issued last week by the Department of Transportation extending the service to both Dubuque and Waterloo, that over the weekend United Express has changed its schedule and cut its flights. What does DOT intend to do about this, or do you intend to do nothing about it?

Mr. FORT. Well, we are surprised as you are, Senator. We, of course, were not notified beforehand of this proposed schedule change. We have not had a chance to even verify it, to attempt to determine exactly what the carrier has in mind.

It appears from what we have heard this morning that technically the carriers are in compliance with the order. I think it was you, sir, who said that, well, there may be technical compliance, but the spirit of the matter seems to have been ignored, and that is possible. It is also possible that there is a technical violation because, whereas, we specifically required no more than two frequencies, there is an ongoing, and overarching requirement that the schedules be reasonable. It is possible that that has not been complied with. I think it would be premature to say what we are going to do at this point, having just found out about it, but we will certainly look at it.

I think the carriers have not shown themselves to be unreasonable as we have attempted to work through this problem. I don't expect that attitude as we now turn to this new schedule. And we will attempt to work out something that is consistent, both with the community needs and the carrier's abilities.

Most importantly, what this shows is that what we need to do in Washington is to get on with finding a carrier that wants to serve these communities. The fact is that we have an unwilling bride. You will get service patterns that don't reflect community interest. Here we have an unwilling bride. The carrier stated its intention to get out. We are holding it in. We have at least three, and perhaps other carriers that are interested. I think we need to get on very rapidly with selecting those carriers, getting that service in place, so that we don't really have to address through regulatory or administrative means this kind of thing.

Senator HARKIN. Not only do you have an unwilling bride, you have got an unwilling bride who wants to take the church out of town so nobody else can get married, with the slots. Let me just ask you this. Are airlines not required to seek schedule change approval from DOT? Are they or not?

Mr. FORT. They are not, sir.

Senator HARKIN. They don't have to seek approval for schedule change?

Mr. FORT. Well, they do not have to seek approval for schedule change. There is, as I said, and I will let Mr. Coleman elaborate, a general provision that requires reasonable scheduling. But, of course, carriers make schedule changes all the time, and frankly, we would be overburdened if we were looking at those.

But clearly there is an area of reasonableness. And for the most part, schedule changes take place within that area. Where there is a community concern about a schedule being proposed that can't

meet anyone's needs, where subsidies are being provided and the allegation is that the Essential Air Service is really not being provided as a consequence, we do have the ability and in fact exercise the authority to encourage appropriate schedules.

Senator HARKIN. Well, I just understand now, again, they now have twice a day direct flights from Chicago into Dubuque. And July 6 they are going to be twice a day but going through Moline, at 8:05 a.m. and at 6:15 p.m., a whole day—almost a day's difference there. Again, I'm concerned that this is very disruptive in terms of the schedule changes that they are going to institute during the period of time for which they are, you, DOT, has mandated that they have to continue that service to Dubuque.

Again, I just ask, is there anything that you can do about it? I mean, are you helpless, or can they just do this and you have no power to say, well, listen, why don't you keep the same schedules you had before, at least? Are you powerless to do anything about it?

Mr. FORT. Well, I think we would be acting beyond our authority to mandate that they maintain without change the existing schedule. However, we do have the ability, if they change the schedule to one which is unreasonable——

Senator HARKIN. Reasonable. That's the key. Well, I'll ask Mr. Coleman. You're the head of Essential Air Service. Do those schedules seem reasonable?

Mr. COLEMAN. Based on the description that I heard this morning, the schedules between Waterloo to Chicago sound to me on their face to be particularly troublesome. There is language in our definition in which we guarantee specifically what air service communities are entitled to, a discussion about the reasonableness and of timing. And what we say is that we expect the schedules to be relatively early in the morning and late afternoon. We don't say it has to be between 7 and 8, or anything that finite. But it does have to be within the spirit, such that a businessman could leave in the morning and come back in the afternoon. That's the idea of it.

We will talk to our legal staff when I return to Washington. And if they share my concern, that this goes beyond what we are entitled to expect from the carrier while it's being held in, our first step would be to contact the carrier, try to work with them, to reinstate something that is more useful. If they are not willing to do that, then we may have to consider enforcement action. But the first thing we have to do is to determine whether or not this does violate our requirements.

Senator HARKIN. Could you get back to me some time later this week?

Mr. COLEMAN. I would be happy to.

Senator HARKIN. In Washington, just get in contact, after you look this over. I would appreciate it.

Mr. COLEMAN. Certainly.

Senator HARKIN. Thank you. That's the problem at hand and I want to talk about that. I have some other more general questions that go beyond this direct route. Obviously I'm looking at the impact on communities beyond, also, the State of Iowa. You mentioned the business travel early in the morning and late in the evening.

We have this interim service that we have been talking about. Now, let's talk about the permanent service to these communities. Mr. Coleman, you raised the point that about the crucial question for business passengers is their ability to fly out and back in the same day, early and late flights being very important. Can these cities, Dubuque and Waterloo, be assured that they will have flights that will allow such a flight pattern as they have had in the past?

Mr. COLEMAN. That is a fundamental element of our guarantees, yes.

Senator HARKIN. OK. Good. Another key question, you have heard it raised, that will determine the viability of the service, is the type of planes used. Will the passenger desire for larger aircraft be given any kind of consideration in this at all or not? Is that a factor?

Mr. COLEMAN. That's a more difficult issue. There are two kinds of communities that we deal with in the Essential Air Service program. There are those that really need us because without subsidies, there would be no air service. The other group of communities, because I like to segregate them, are those where there are real markets. Dubuque and Waterloo are real markets. They have demand and they do generate traffic.

Senator HARKIN. How much input will local officials and business leaders have in the decisionmaking process—again, looking toward the permanent service that will come after this interim period?

Mr. COLEMAN. Again, I lost my train of thought here.

Senator HARKIN. I'm just wondering, will you provide some means for the business community in these areas?

Mr. COLEMAN. Yes. We are anxious to hear from all segments of the community. And, in fact, we have already received a great deal of correspondence. Ultimately what I was leading up to is that we strongly prefer, and I think the communities would agree with us on this, not to intervene in certain factors with the air service's money involved, such as aircraft type, specific type of schedules, flight itineraries, those kinds of things.

We don't want to do things in a way that will interfere with the discretion of carriers, who are the expert managers of the airline business. We are not. We don't want to interfere with their ability and willingness to try to make the thing work in the most productive way.

So yes, to the extent that we have to get involved in making actual selections of carriers. Where there are subsidies required, we certainly give weight to such things as type of aircraft. Where we don't have to make those kinds of decisions, we strongly prefer not to. And we believe that it's in the best interests of the communities for us not to.

Mr. FORT. Senator, let me try to answer your question slightly differently. We don't have a calculus. We don't say larger aircraft plus five, smaller aircraft minus two. Eight in the morning plus three, 9:30 minus two. We don't have a calculus.

The order that we put out last week inviting proposals for both service to Dubuque and Waterloo to Chicago established an expedited timetable. We are looking for 10-day comments, and we very

explicitly indicated that we would be looking for community comments on those proposals, once received.

What we have done in the past, what we will do here, is to give very great weight to those community views. Sometimes a community says I like carrier A, not carrier Z, even though carrier A has a small aircraft and operates at 9, versus Z's larger aircraft at 8, and even though carrier A's subsidy Bill is higher than carrier Z's. At the same time we have gone the other way.

But in all cases we have given very great weight to community views and we have had to maintain the flexibility by not establishing a formal calculus so that we could give that weight to the community. Because a community might like carrier A, not withstanding the fact that it has larger or smaller aircraft, or 9 versus 10 departure times, for reasons of perceived commitment by carrier management to the community. That weighs a lot in their view, and in our view.

Senator HARKIN. Again, I know you are looking at an expedited procedure here, but you will afford the communities involved some span of time to comment upon the proposals that have come in.

Mr. FORT. Absolutely. Absolutely.

Senator HARKIN. Again, looking at this permanent service, how can communities be assured that once the new carrier starts their service that they will not go to an alternative market in a couple years? In other words, who is going to own these slots, and what would happen to the slots if the chosen airline decided to go elsewhere? Are we going to face this thing down the road again in maybe another year, year-and-a-half?

Mr. FORT. We have a policy with respect to slots, with respect to Essential Air Service community operations to high density airports, slot control airports, that I think will cover that situation. As our order makes clear, there happen to be slots available out of the commuter pool at O'Hare that will be made available to the carrier selected, if that carrier so wishes. We will tag those slots for these communities. We have done that in the past, very isolated, very rare instances, to be sure. Where the carrier serving one of these high density slot airports actually ceased all operations, we attached those slots and have since made them available only to carriers desiring to operate Essential Air Service to those airports, and we can do that in this case.

So our rule provides not only that flexibility for us, but provides other ways in which we can address the particular needs of communities. I mentioned a couple of them in my testimony already. But as an ultimate safeguard, the Department has, under the buy/sell rule, the ability to activate a reverse lottery and actually take away slots from carriers so as to be able to provide needed Essential Air Service to high density slot airports.

So there is a whole range of options available to us. And frankly, as this case makes clear, we really don't have to resort to these kinds of administrative draconian means. We have the slots available here that will be made available to the carriers. That has been our experience.

Senator HARKIN. Well, I don't know. I mean, obviously this situation basically was taken care of, but the fact is, the airlines still own those slots. DOT did step in on this one, but that's not to say

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that DOT steps in on them all. There could be other places where they don't step in.

Mr. FORT. Section 419 does give the Department discretion in this regard. The law requires that we administer a program that maintains Essential Air Service pursuant to certain statutory criteria. Once the determinations are made, both service and frequency, hub determinations are made and are in place. If they are to be violated, then we have the statutory responsibility to insure that the service is maintained.

If a carrier, for example, as in this case, but in any case, wishes to cease Essential Air Service in a community in which it has that responsibility and owns slots in one of the high density airports that would be affected, then we can prohibit the carrier from doing so. If he wants to sell a slot in such a way that it would no longer be able to provide the Essential Air Service, we prohibit the carrier from doing so by holding the carrier to its agreement to provide service until we fired a subtitute carrier.

And finally, if we are faced with a situation in which we have to take slots away from a non-EAS carrier in order to make sure that Essential Air Service is guaranteed, we are statutorily given, through our administrative procedures, that flexibility and are empowered and required to do so. So I honestly believe that the situation is covered.

Senator HARKIN. OK. Let me get into the mergers here. Late last year there were two airline mergers of special interest in the Midwest. TWA bought Ozark. Both carriers had a considerable part of their flight activity at St. Louis and together, I understand they had a great majority of the jet traffic at St. Louis. About the same time, Northwest bought Republic. Both of those carriers had a large part of the jet traffic in Minneapolis. Why didn't those mergers raise the specter of excessive market concentration at those airports, or perhaps they did? Again, the mergers were approved.

I am wondering why they were approved, considering the share of the market that they had at the respective airports: TWA at St. Louis, 81.5 percent of all passengers; Northwest at Minneapolis, 80.6 of all passengers. I don't know if you can answer the question, about why they were approved, but I'm just wondering, in light of the concentration that they have, the market sharing concentration they have there, was that a wise step to take?

Mr. FORT. Well, sir, we were, of course, intimately involved in the staff analysis with respect to those transactions and with respect to developing the recommendations for Secretary Dole in the case of both of those. I think maybe a little historical perspective would be useful in trying to answer this. When the Airlines Deregulation Act was enacted in 1978, the new Section 48, that part of the statute dealing with our responsibilities for oversight of mergers, was created, specifically, reducing the old public interest criteria that the CAB primarily employed in reviewing mergers.

Under the old mostly public interest criteria, the board often disapproved mergers, not because the mergers would be anticompetitive, but really because it would undermine the industry structure that it was regulating. That was appropriate. Congress specifically said with the Deregulation Act that we want to move the airline industry into a position so that it's treated like all other industries

now, the same antitrust standards that govern other non or deregulated industries.

And so in carrying that out, what we look at as is employed with respect to other merger transactions, or acquisitions, is whether or not competition will be substantially reduced. And that's not a formalistic evaluation. That's a very functional evaluation. The fact that at Minneapolis, Northwest/Republic will control 80 percent of the traffic is not determinative, because the question is not how much traffic do they control, but whether or not they can preclude other carriers from entering that airport and making inroads into its market share. The same thing at St. Louis.

And what we found is that there was no barrier to other carriers entering either the St. Louis or the Minneapolis airports. No slot constraints. No facility constraints. No gate constraints. And so our approval of those mergers rested very largely on the fact that if United or Continental or any carrier wanted to challenge the hub strength of one of those carriers at its hub, it would be able to do so, and the mere threat of that entry would serve to discipline any desired use of market power.

Senator HARKIN. I wonder if that's really valid. First of all, antitrust considerations are determined by the DOT, not by the Justice Department.

Mr. FORT. Yes.

Senator HARKIN. Again, that's because of the way it was set up. I think it is going to the Justice Department, though, when?

Ms. BARKER. 1989.

Senator HARKIN. From 1989 on these questions will be decided by the Department of Justice.

Mr. FORT. That is correct, if not before.

Senator HARKIN. Now, last year these two instances I talked about, did not the Department of Justice object? This was approved over the Department of Justice's objections?

Mr. FORT. In the case of the Northwest/Republic merger, the Department of Justice did intervene in that case and argued that that merger should be disapproved. My memory fails me with respect to TWA/Ozark, but I believe that it's also the case that they argued against the approval of that transaction.

Senator HARKIN. I see nodding of heads, yes, they did. I don't know myself.

Mr. FORT. But there have been other cases in which the Department of Justice has argued that we ought to approve, in which we have come out on the other way. So there is no consistency of view, except in our treatment of these I think we have been consistent in establishing and imposing criteria on the transactions.

Senator HARKIN. Again, I wonder, you say the mere threat of others coming in, that could come into these hubs—when Northwest, for example, has 80 percent at Minneapolis, but there are other barriers, counterspace, control of counterspace, control of the gates, the ability to drop the price in a particular market, joint fares, a lot of things like that, that because of this powerful concentration at one hub Northwest would preclude everyone else from really coming in there. You might say another carrier could come in. But if your counter is back down the stairs some place you might not be able to do that, or if your gates are clear out on the

end a half a mile away some place, that sort of discourages you if you can't get up close, you see. So there are other barriers.

Mr. FORT. We looked very, very carefully at the Minneapolis situation. An acquisition of that magnitude, that produced that level of concentration on its face, obviously was trouble for us. We looked at it very closely. And the Minneapolis/St. Paul Airport authority was a participant in the case, and filed a good deal of information which was very useful to us.

And that documentation, sir, was explicit, that there would be no—that all carriers would have ample gate space and other facilities available to it. They were to be assured long-term leases in which both Northwest and Republic would maintain. But the airport had long since been practicing the policy of forcing incumbent carriers to make room at its principal facilities, gold and red and green concourses, as opposed to the other terminal tool, whatever it's called, making space available to new entrants. And the airport authority assured us that that policy would be maintained.

Senator HARKIN. This is sort of a recap of some of the things I have been getting into, but a key element in the ability of smaller cities to attract many types of businesses is the availability of air service, and not looking at it for the next 2 months, but what it's going to be like 5 years from now, on down the road. That's one of the essential needs I see for this Essential Air Service, is long-term reliability. How can we have this long-term assurance of continued service, without Essential Air Service, which is going out next year; right? 1988. Now, there are bills pending to extend the Essential Air Service, some indefinitely, some for 10 years, 5 years, that kind of thing. I guess I'm just wondering about the Department's view on this, and has the Department taken a view on the extension of Essential Air Service?

Mr. FORT. Yes, sir.

Senator HARKIN. And the Department's position is?

Mr. FORT. We oppose the extension of Essential Air Service. Yes, sir.

Senator HARKIN. How can this long-term assurance of air service be had without the continuation of Essential Air Service?

Mr. FORT. We were here this morning, and we did hear the rather powerful testimony of several of the witnesses about the relationship of air service to their business decisions locating and staying, with respect to locations and staying in the communities. I don't want to suggest that we didn't hear that testimony, we did.

But in the scheme of things, sir, in all candor, it's anecdotal at this point. The evidence which we have, which is admittedly perhaps a little stale, but all kinds of comprehensive evidence that we have to this point suggests the opposite, that air service is really not a critical component in this business—in the executive decision to locate or to move.

Senator HARKIN. Do you have any recent studies other than 1974 or 1975?

Mr. FORT. Unfortunately, we have canvassed the literature, and we have not done one ourselves.

Senator HARKIN. Let's be honest about it. Back in 1974 and 1975 you had a regulated service. This wasn't any concern. If I was a business person and I was asked to outline it, I wouldn't probably

even consider it because it was not a problem then. But today it is. And not only that, but the changing world scene and the competitive markets that are out there, the whole situation has changed since 1975. As you heard this morning from some of the witnesses indicating it really has changed. And I would really challenge that data today. I wouldn't have challenged it then, I assume it was correct then, but I challenge it in light of the new competitive markets that we have today.

Mr. FORT. It seems like it's time for a review.

Senator HARKIN. Maybe we will look at that. Is the Department of Transportation reviewing its regulations governing the number of air traffic controllers needed at airports and the number of small and large runways permitted at airports to determine whether present policy should be changed to enhance the capacity at all airports? Since the number of air traffic controllers and runways have a direct bearing on the capacity of airports, and in light of the limited number of slots, shouldn't such a study be undertaken immediately? Since air traffic controllers and runways obviously determines member of the slots, shouldn't we do a review as to what's needed at some of these major airports and hubs?

Mr. FORT. Sir, the aviation reorganization legislation proposal which Secretary Dole sent to Congress, the administration sent to Congress this year, substantially increases funding for refurbishing of our airway system. That includes air traffic controllers and also facilities and equipment, as well as the airport improvement program. The bill proposes an increase in overall spending by 20 percent, and that's critical funding for controllers, for safety inspectors.

Senator HARKIN. What bill is this? I'm sorry for interrupting you.

Mr. FORT. Our authorization package, FAA authorization

Senator HARKIN. 20 percent.

Mr. FORT. 20 percent overall. 68 percent increase for facilities and equipment over the fiscal year 1987. That is, the improvement of our computers——

Senator HARKIN. What's the 20-percent increase over?

Mr. FORT. Over fiscal 1987. For some reason I'm thinking we are in the last decade. Fiscal 1988 over 1987.

Senator HARKIN. There was a 20-percent increase.

Mr. FORT. 20 percent. It was a 2-year package we set up with similar figures for fiscal 1989. The other years weren't included in the package, but we also contemplate similar increases for the out years. Now, last week Secretary Dole sent to one of her colleagues, Senator Chiles, a very blunt letter asking for favorable consideration of this legislative proposal submitted by legislation. We have heard testimony today. We agree with that testimony 100 percent.

The Congress over the last 6 years has underappropriated over $1 billion for the FAA's operation. And the trust fund grows. And we believe that it is critical. We are at a critical stage in our airway and airport programs, where funding is absolutely critical to stay abreast of the needs of today and tomorrow.

Senator HARKIN. Over what period did the Congress you said underappropriate $1 billion?

Mr. FORT. Over the last 6 years.

Senator HARKIN. I'll take a look at that. I'll take a look at this since I am on the Appropriations Committee. I remember that we had a problem in the last few years getting the money to upgrade the computers and hiring controllers, and there was one other thing too. I think it must be the landing systems or something that sticks in my memory.

Mr. FORT. That's absolutely right, Senator. And, of course, the FAA, DOT, has been able to kind of make do by—there are several budgets within the overall FAA budget—by robbing Peter to pay Paul we have been able to make do to keep our National Air Space plan on track. But now we are at a critical juncture, and the Congress proposal is to slash over 500 million dollars from our fiscal 1988 request. And that will, frankly, lead to rather—really dire circumstances. I can't stress——

Senator HARKIN. And that's money from the trust fund.

Mr. FORT. That is from the overall appropriation. It's, as you might imagine, a very complicated subject. But the trust fund has built up as a result of ticket taxes. We believe that the trust fund should go to—those ticket taxes should be used to pay for operational expenses. We believe that the proceeds of those taxes should pay for about 85 percent of the overall FAA budget. And so we would propose that the trust fund, that the recovery out of the trust fund for operational expenses be approximately 75 percent. With 100 percent recovery for other FAA expenses, this would amount to 85 percent overall.

But, of course, that view is disputed by some in Congress who would not have the trust fund be used to that extent. Therefore, there has been an underappropriation. The authorizing committee, fearing the underappropriation, has attached a penalty, such that every dollar that is underappropriated requires even more monies out of the general treasury. Thus, we are in a serious Catch-22 and the trust fund keeps growing. Our facilities and equipment, controllers' equipment, computer equipment, are now at a point where we really are going to have to stall the development of that unless we can work out a bill which permits adequate funding.

Senator HARKIN. But if we use all of our money in the trust fund to pay operating expenses, are we going to have enough left for the upgrading of computers and everything else that we need?

Mr. FORT. That's an excellent question. Our budget specifically provides for the payment for the upgrading of our NAS plan system, National Air Space system, and at the end of a 5-year period would leave $1 billion in the fund for emergency use, so to speak. Our budget, I think—I would be silly to suggest that it's perfect. We worked on it very carefully. We believe that it meets the needs. Critical differences exist with the Congress only on the amount of recovery out of the trust fund for these operational expenses. And the differences within the Congress, between appropriations and authorizing, over who and to what extent should a penalty attach to the lack of appropriation.

Senator HARKIN. Well, I'm going to have to draw this to a close.

[Material follows:]

U.S. Department of Transportation
Office of the Secretary of Transportation

Assistant Secretary

400 Seventh St. S.W.
Washington, D.C. 20590

Ms. Tracy Crowley
Hearing Clerk
Committee on Small Business
Room 428A
Russell Senate Office Building
Washington, D.C. 20510

Dear Ms. Crowley:

In response to the questions contained in the letter to me cosigned by Senators Harkin and Bumpers, I submit the following answers. I understand that this material will be added to the record of my testimony before the Small Business Committee's Subcommittee on Competition and Antitrust Enforcement, which took place on June 1, 1987.

QUESTION: United and American have been long term carriers serving the Des Moines route. And, for much of that time, they have charged identical fares. In late May, the unrestricted one way fare was $220. I understand that those airlines were actually charging less to fly to Washington, D.C. than they were charging to Chicago. Some presume that the lower fare to Washington is largely because customers have alternative ways to reach Washington from Des Moines. Is this appearance of collusion to establish a very high price based on control of a marketplace by two cooperative airlines a question that U.S. DOT should look into under the law? If so, please explain what the appropriate statutes and regulations are. If it is not, does the Department believe that this type of price setting is appropriate or should it be considered a violation of law?

ANSWER: All domestic air carriers are subject to significant competitive pressures, including those that operate in the Des Moines-Chicago market. In fact, it is our view that airline fare competition is greater now than ever before and that the public has benefited enormously from the price and service options brought forth by deregulation.

Prior to deregulation, air fares were tied quite closely to a distance-based formula that permitted little price competition and in many markets fares were seriously out of line with costs. Under deregulation, however, competition has spawned a wide range of fare options. Discount fares are especially prevalent: roughly 90 percent of all passengers travel on a discount fare, which is, on average, approximately 60 percent of the full coach fare.

Air fares in short- and long-haul markets have evolved in response to increased competition and the readjustment of the airlines' route networks. For example, the industry's current fare structure is a response to the growth and expansion of hub-and-spoke route networks, the decline in interlining, marketing alliances and code-sharing arrangements, the proliferation of deep discount fares, peak and off-peak pricing schemes, and new promotional schemes, such as frequent flyer programs.

Fare competition is not directly related to the number of air carriers serving a market, as you suggested, because potential competition from existing carriers and/or the threat of new entry also serves to prevent air fares from rising. Air carriers also face competition from alternative forms of transportation (e.g., intercity bus and the automobile in short-haul markets); and alternative routing choices, such as through alternative hub airports, provide travelers with a greater array of fare and service options.

As to the particulars of fares in the Des Moines-Chicago and Des Moines-Washington markets, we offer the following observations:

1. United and American, which serve those markets, can hardly be characterized as "cooperative airlines," because they engage in vigorous competition with each other nationwide with particularly intense competition occurring at their Chicago hubs.

2. On June 25, 1986, we contacted both carriers to determine their fares in the instant markets and were quoted differing fares for the two carriers:

	AA	UA
Des Moines-Chicago (round trip)		
* unrestricted coach fare	$466	$374
* lowest available coach fare	158	194
* highest of the discounted coach fares	244	214
Des Moines-Washington (round trip)		
* unrestricted coach fare	610	610
* lowest available coach fare	208	208
* highest of the discounted coach fares	328	248

3. As shown above, fares to Washington were not lower than fares to Des Moines. On average, the fares to Washington were 31% higher than the fares to Chicago. This is not proportional to the different distances in the two markets, but this is not unusual because average costs tend to decline as distance increases and are a function of other factors, such as the number of passengers in the market. For more detail, please refer to the attached analysis of airline costs and fares, which is excerpted from a CAB Report to Congress on airline deregulation.

4. Passengers in the Des Moines-Chicago market also can take advantage of the competition offered by a variety of direct flights to Chicago's Midway Airport offered by Northwest and Midway Airlines.

Based on the above information, we believe there is effective competition in the Des Moines-Chicago market.

QUESTION: Does the Department exercise any oversight of the resale of slots by major airlines? Does DOT keep and record on the number of slots available to each airline and the price at which these slots are sold? If not, why not?

ANSWER: The Federal Aviation Administration reviews and approves slot sales, leases and trades. The review undertaken is to ensure that the carriers legitimately hold the slots being sold, traded or leased, and to assure that certain conditions relating to Essential Air Service, international air service, and lottery slots are not violated. Once these conditions have been met, the transaction is approved.

The FAA keeps records of the carriers and slots involved in the transactions and whether the slots are sold or leased. This information is used to ensure that carriers do not operate more than the number of slots to which they are entitled and that the slots are being actively utilized, as well as to approve transactions. Information on the considerations in the transaction, whether money or otherwise, is neither solicited nor recorded because such information is not subject to review or approval by the FAA.

Sincerely,

Vance Fort

Vance Fort
Deputy Assistant Secretary for
Policy and International Affairs

Enclosure

CIVIL AERONAUTICS BOARD

REPORT TO CONGRESS

IMPLEMENTATION OF THE PROVISIONS OF THE AIRLINE DEREGULATION ACT OF 1978

As Required By Sections 1601(c), (d), and (e)
of the Airline Deregulation Act of 1978

January 31, 1984

2. AIRLINE PRICING POLICIES

Airline deregulation, in part, stemmed from a growing perception that airline fares were too high. The experience since the Board began loosening its regulatory hold on airline prices confirms this belief: air fares have increased far more slowly than costs. This, in turn, is forcing carriers to become more efficient.

Deregulation is also producing a fundamental change in the structure of fares. Fare differences between markets are now more likely to be the result of cost differences. Also, carriers are charging higher fares to passengers who travel at times of relatively strong demand. In some markets this is the product of explicit peak-load pricing, while in others it is accomplished through a system of capacity-limited discount fares. Market-based prices are encouraging carriers to tailor service to meet market demand.

Board Fare Policies Under Regulation

One of the Board's primary regulatory concerns was the financial condition of the industry. In setting fares, the Board tended to focus on carrier profitability rather than on the relationship between fares and costs in particular markets. Fares in all markets were generally adjusted in unison; yet, in a large number of markets, fares differed substantially from costs. Moreover, the disparity between fares and costs increased as new aircraft technologies were introduced. In addition, despite the large variation in demand over the day and week, the Board never formally considered the advantages of peak-load pricing.

Fare competition was not precluded by statute, but the CAB's procedures and policies discouraged it. Proposals to substantially change fares were the subject of hearings. Consequently, fares were not changed quickly, and an airlines' competitors had ample opportunity to challenge any proposal.

When the Civil Aeronautics Board was created in 1938, passenger fares were set at roughly the prevailing Pullman rates for train travel. They, therefore, were proportional to distance. Given the nature of airline operation at that time, this structure of fares was probably not seriously out of line with the cost of providing air transportation. However, after World War II, new aircraft such as the DC-6 and the Lockheed Constellation were introduced. These aircraft had substantially longer ranges and faster cruising speeds than their predecessors. They were also cheaper to operate. A more dramatic technological advance was the introduction of jet aircraft in the late 1950's and early 1960's, which further reduced costs while increasing the convenience of air travel.

Despite these important changes in technology, the Board failed to force a realignment of fares. Instead, it allowed carriers to introduce new services and to expand their use of discounts. Discounts were intended to widen the market for air travel by lowering fares for groups of travelers whose demand was sensitive to price. Consequently, average fares declined somewhat; however, the decline did not keep pace with the reduction in airline costs. For example, between 1960 and 1969, the trunks' average seat-mile cost declined by 21 percent; average fares declined by only seven percent.

The disparity between fares and costs gave carriers in competitive markets (more than one carrier was authorized to provide service in major markets) strong incentives to engage in excessive non-price competition. The primary forms of non-price competition were scheduling additional flights and offering roomier seating. Thus, for much of the post-World War II period, load factors (the percentage of seats filled) declined, which offset some of the cost advantages of the new aircraft.

In 1969, with load factors at their lowest level since World War II and profits deteriorating sharply, the airlines came to the Board for price increases. This ultimately led to the Domestic Passenger Fare Investigation (DPFI), the first time in the Board's thirty-year history that it explicitly considered the structure of fares. In the DPFI, the Board decided to set air fares according to a distance-based formula; the formula was intended to reflect airline costs for a standardized load factor, seating density, and service quality.

The fare formula was more in line with the cost of service than the prevailing fare. Yet the Board deliberately set fares below costs in markets of less than 400 miles so that air transportation would be more competitive with surface modes. To compensate for them, fares in longer haul markets were set above costs. Since the DPFI was based only on distance, the fares established in many markets remained seriously out of line with costs. For example, the average cost of service falls as the number of people traveling in a market goes up, yet market density was not considered in establishing fares. Moreover, the Board decided that the cost of providing service to a passenger traveling on a discount fare was no different than the cost of a passenger traveling on full fare; in order to limit cross-subsidy the availability of discount fares was ordered sharply reduced.

Trends in Air Fares and Load Factors

The Domestic Passenger Fare Investigation created a rigid distance-based formula for standard fares and greatly restricted the use of discounts. Thus, there was even less room for price competition in the early 1970's than had existed earlier. However, steps were taken to liberalize charter rules beginning in 1975. It was not until

1977 that the Board signaled its willingness to become more flexible in its regulation of fares by approving Super Saver and Peanuts fares. These actions signaled a fundamental change in the Board's policies as carriers proposed, and the Board approved, a wide range of discount fares. In 1978, the Board adopted a zone of flexibility which granted automatic approval to fares that were up to 10 percent above the DPFI formula and 70 percent below it. In 1981, the Board granted carriers further flexibility. The Board lost its statutory authority to regulate domestic fares on January 1, 1983.

The result of these actions has been a fundamental change in airline pricing policies. Two basic pricing strategies have emerged under deregulation. The most prevalent strategy has been to offer restricted discounts in addition to coach fares. However, some carriers, most notably the new entrants, have introduced unrestricted low fares at or below the prevailing discount fare levels. Often these carriers charge higher prices for service in peak travel periods than in off-peak periods.

In some respects, the discount fares that have been introduced under deregulation are similar to the discounts in the 1960s. They focus on discretionary passengers and are an attempt to offer reduced prices to the most price elastic segment of the market. However, many of the earlier discounts (like the youth fares) were only available to specific types of individuals. Carriers are now more likely to use advance purchase and minimum stay requirements to differentiate discretionary and time-sensitive passengers. The most significant feature of these discounts, however, is that they are capacity controlled; the number of seats available for discount passengers on a given flight is limited. Consequently, discretionary passengers traveling on reduced fares will not prevent time-sensitive passengers paying full fare from traveling on their preferred flights. By limiting the number of discount passengers on a given flight, restricted discounts may achieve the same effect as peak-load pricing; passengers traveling during periods of high demand will pay higher average fares. In addition, in some markets, lower restricted discount fares are available on less popular travel days.

Passenger demand not only varies throughout the week, it also varies throughout the year. For example, traffic is strongest during the summer and weakest in January and February. Over the past several years, carriers have offered fare reductions in a broad range of markets during these low-demand periods, thus encouraging passengers to travel during these off-peak periods.

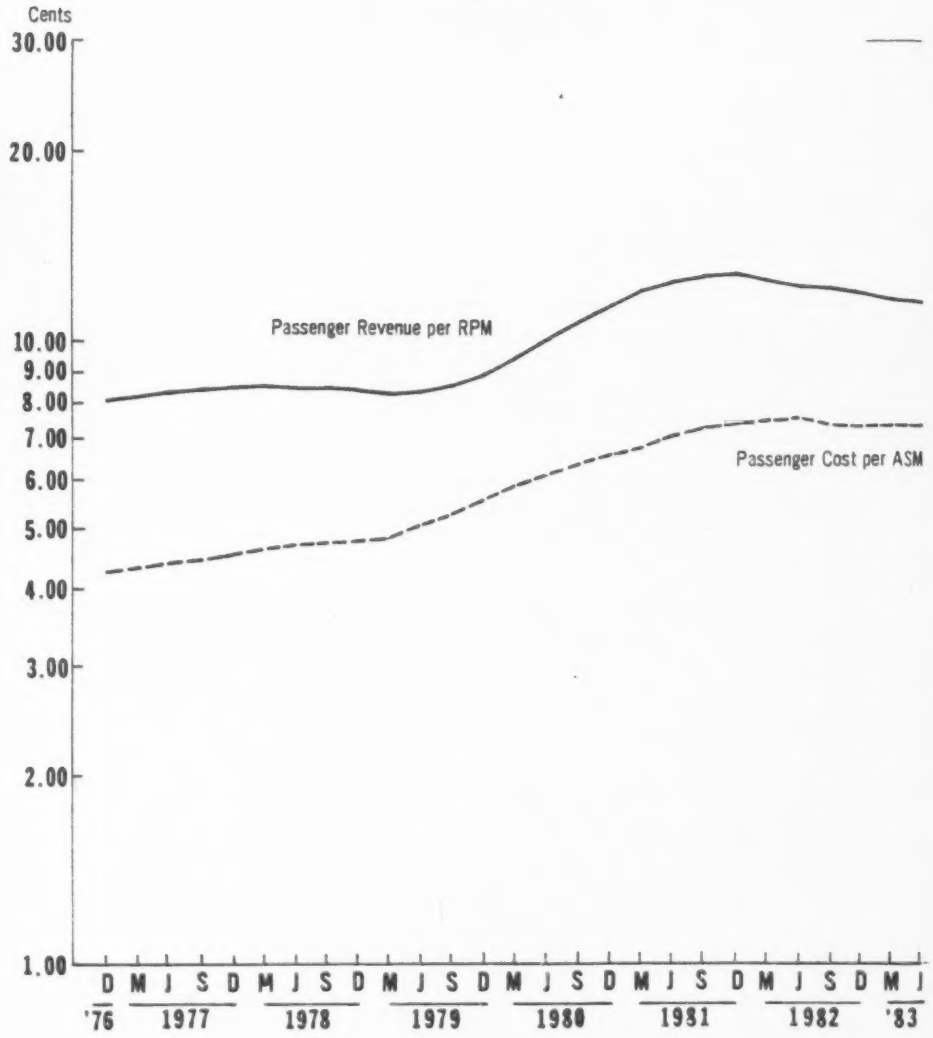
The use of peak-load pricing promotes a more efficient use of the airline industry's resources. If airlines were to use their stock of aircraft intensively, and all passengers were charged the same fare regardless of when they traveled, load factors on different flights would vary considerably; they would be quite high at peak travel times and quite low on less popular flights. This is the type of pattern that regulation encouraged. The use of peak-load pricing encourages travel at less popular times, and therefore enables carriers to serve more passengers with a smaller stock of aircraft. It thereby reduces the average cost of air service.

Figure 2.1

AVERAGE FARE PER REVENUE PASSENGER MILE AND AVERAGE COST PER AVAILABLE SEAT MIL

Formerly Regulated Carriers

12 Months Ended Data



The effect of the more flexible regulatory regime on average industry fares is illustrated in Figure 2.1. For the trunk and local service carriers the figure shows changes in both average yields (fare per mile) and their average cost per available seat-mile on a 12-month basis. Between 1976, the year before the Board relaxed its regulation of fares and 1980, fares increased less rapidly than costs. In the spring of 1979, fuel prices began to increase rapidly and consequently airline costs shot up as well. The average price of fuel increased by more than 150 percent between 1978 and 1981, before declining somewhat thereafter. The Board adjusted its fare ceilings every two months to accommodate the cost increases. Moreover, the ensuing recession depressed traffic growth, and load factors fell, further increasing average costs. In May 1981, the Board expanded substantially its zone of flexibility and carriers raised fares more rapidly than their costs rose. Part of this runup may have been due to regulatory lag: if ceilings had been higher, fares probably would have increased more rapidly than they did in the preceding year.

Fares have had a downward trend since the first quarter of 1982. Cost increases slowed and the price of fuel began to ease. However, the reduction in prices was greater than the cost decreases and was a predictable result of the excess capacity during the recession. Competition has encouraged airlines to cut fares in order to stimulate traffic rather than allowing their aircraft to sit idle. The carriers' losses indicate that fares throughout this period did not fully cover costs (including the capital costs of the aircraft). Nevertheless. they did cover out-of-pocket costs and a share of the overhead costs.

Between 1976 and the year ending June 1983, air fares have increased considerably. Nevertheless, the increases were less than increases in either the Consumer Price Index (CPI) or increases in carrier costs. During this period, the formerly regulated carriers average seat cost increased by 71 percent, yet fares increased by 45 percent. Between the year ending September 1978, just before the ADA was passed, and June 1983, fares increased by 39 percent. At the same time average seat-mile costs increased by 54 percent, slightly more rapidly than the CPI.

Increased fare flexibility has enabled carriers to achieve higher load factors than they achieved under regulation. Since demand for air travel tends to be reasonably price elastic, selected fare reductions stimulate traffic. Throughout this period load factors were substantially above the 55 percent level that the Board determined was appropriate in the DPFI (see Figure 2.2.). Even during the economic slump of 1981 and 1982, load factors were at higher levels than they had been since the mid-1960's. Since it costs relatively little to accommodate a passenger in an otherwise empty seat, increasing load factors is an important way to reduce the average cost of air service.

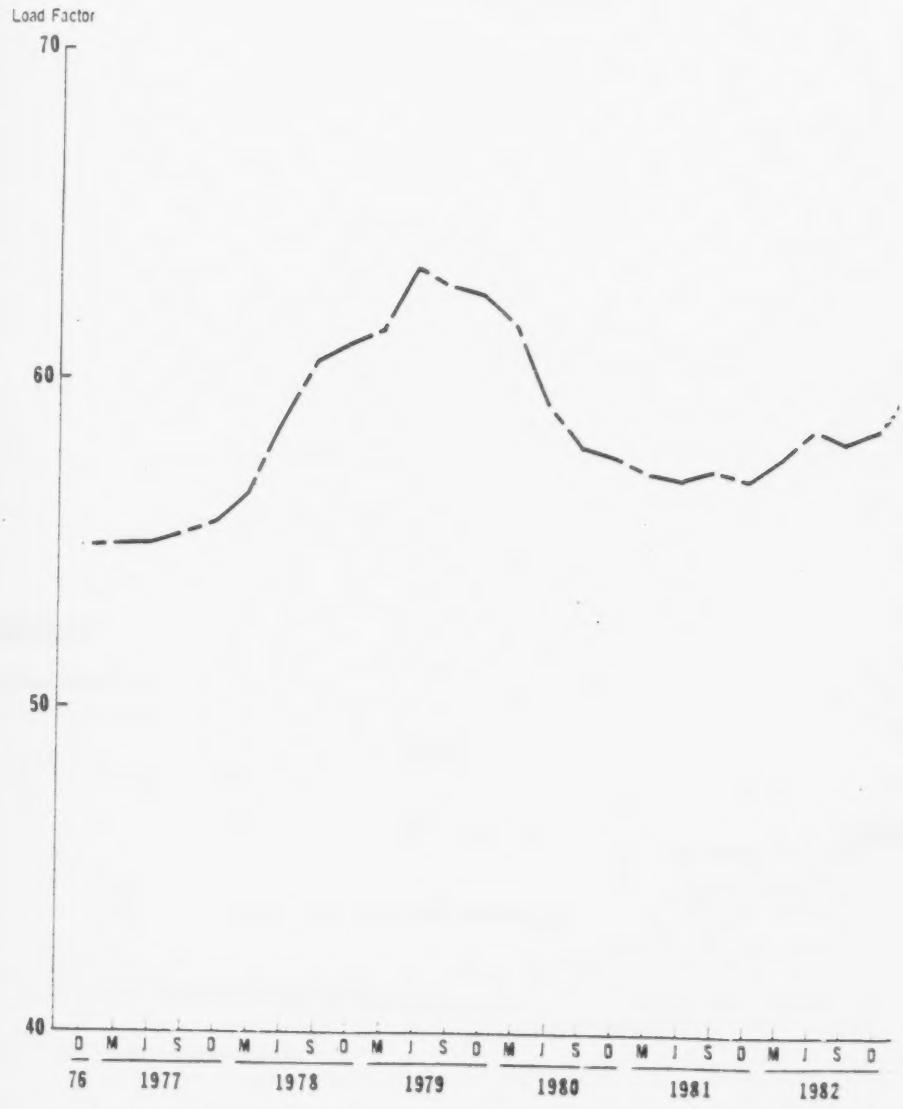
In addition to underating increases in air fares, changes in airline pricing policies have also reshaped the structure of air fares across all markets. As we now show, these changes appear to be bringing fares more closely into line with costs.

Figure 2.2

AVERAGE LOAD FACTORS

Formerly Regulated Carriers

12 Month Ended Data



Fares and Costs

The cost of providing air service varies across markets. As already noted, the cost of service increases with market distance, although less than proportionately. In addition, the average cost of providing air service falls as the number of passengers per flight increases--both because of increasing load factors and increasing aircraft size. Hence, in bigger markets, where larger aircraft can be used and load factors are higher, average costs are lower.

Airlines could minimize the average cost of serving a market, and hence the fare, by flying large aircraft at high load factors. However, in order to provide such service carriers would have to reduce the number of flights that are offered, which would be relatively inconvenient for many passengers. For example, someone who has to be in St. Louis on Tuesday morning would not be well served by a very inexpensive flight on Tuesday afternoon. Also, as load factors rise, the number of passengers who are unable to secure a reservation on their preferred flight increases. To meet traveler demand for convenient service, airlines provide more flights using smaller aircraft and operating them at lower load factors, than simple cost (and fare) minimization implies.

The aircraft size and load factor that best balances passengers' desire to have both low fares and convenient service depend on the characteristics of the market. Specifically, both load factor and equipment size tend to increase with market distance and density. It is relatively more costly to provide increased flight frequencies in longer haul markets. In addition, the cost advantage of larger aircraft relative to small aircraft increases with distance.

Moreover, as market distance increases, ground transportation becomes a poorer substitute for air travel; thus, air travel becomes relatively more convenient. Thus, the demand for frequent service is greater in short-haul markets. In addition, the cost of providing frequent service is lower in short-haul markets, because the cost of operating an aircraft increases with market distance.

Average aircraft size and load factor can be expected to increase with market density. There are diminishing returns to reductions in travel delay--beyond a certain point added flights do not substantially increase convenience. Thus, as market density increases, carriers tend to operate larger aircraft at higher load factors.

Table 2.1. shows that for the year ending in June 1983, average load factors and equipment size increased with market density and distance as predicted. (This includes 975 markets that had nonstop jet service and for which reliable data was available.) For example, in the smallest short-haul markets, aircraft size (112 seats) and load factor (46 percent) are the lowest in the table. In the most dense, long-haul markets, the average load factor was 67 percent, and the average size plane has 266 seats. Generally, short-haul and less traveled markets had load factors below 55 percent, which was the load factor standard the Board used to compute costs and fares under the DPFI. In longer and more dense markets, load factors are above 55 percent.

The load factor and equipment size observed at any given time is a function of a variety of factors, including the amount of connecting traffic traveling in the market, and the fleet mix of the airlines, as well as transitory factors such as the business cycle. Nevertheless, these data indicate that differences in load factor and equipment size among markets are consistent with an efficient deployment of airline assets.

Table 2.1

AVERAGE LOAD FACTORS AND AIRCRAFT SIZE (SEATS)
Year Ending June 1983

Market Distance (miles)	Market Size (O&D Passengers per Day)							
	10-50		51-200		201-500		501 +	
	Lf	aircraft size	Lf	aircraft size	Lf	aircraft size	Lf	aircraft size
1-400 mi.	46	112	50	116	54	119	59	140
401-1500	54	114	55	124	59	134	60	158
1501 +	-	-*/	59	168	62	202	67	266

Source: Service Segment Data.

*/ Too few markets to provide reliable comparison.

Table 2.2

FARES AS A PERCENT OF DPFI FARE FORMULA
Year Ending June 1983

Market Distance (miles)	Market Size (O&D Passengers per Day)			
	10-50	51-200	201-500	501 +
1-400 mi.	114	112	95	71
401-1500	110	97	87	80
1501 +	*/	75	65	60

Source: Origin and Destination Survey for markets with nonstop flights.

*/ Too few markets to provide reliable comparison.

Table 2.2, shows the average fare as a percentage of the cost-adjusted DPFI fare formula for those same markets. The relationship between the average fares and the DPFI tends to be consistent with the relative costs of service; the fare relative to the DPFI generally decreases with density and distance.

Of course, a market's average fare was not equal to the DPFI formula even under regulation. Discounts were available in many markets, and local service carriers could charge fares up to 30 percent above the formula. Thus, the table does not necessarily prove that fares in any given category are higher or lower than they would have been had regulation continued. Rather, it indicates that the relationship of fares among markets differs substantially from what the Board prescribed in the DPFI.

To consider whether airlines are tailoring their operations to the demands of less time-sensitive passengers, we compared load factors, equipment size, and fares in a group of tourist markets and non-tourist markets (See Table 2.3). Tourist travelers are generally not very time-sensitive and consequently do not value frequent flights as highly as business travelers. We considered markets involving interstate service to Hawaii, Florida, Reno and Las Vegas, Nevada as tourist markets. We also limited our evaluation to markets greater than 1,000 miles and with more than 200 passengers per day.(There were 52 tourist markets and 89 nontourist markets that met these criteria.) In shorter markets, economies of large aircraft are less important, while in thinner markets it would be relatively difficult for carriers to realize any market economies.

Table 2.3

COMPARISON OF LOAD FACTOR, EQUIPMENT SIZE AND FARES
AS A PERCENT OF DPFI IN TOURIST AND NON-TOURIST MARKETS
Year Ending June 1983

Market Distance (Miles)	Market Size (O&D Passengers per Day)					
	201 - 500			500 +		
	LF	Equipment	Fare	LF	Equipment	Fare
1000-1500						
Tourist	64	178	67	63	209	65
Non-Tourist	60	159	77	65	228	67
1500 +						
Tourist	68	245	56	67	318	53
Non-Tourist	64	181	70	67	252	62

Source: Service Segment Data, O&D Survey.

As Table 2.3 indicates, air fares are lower in tourist markets. In part, this reflects the lower cost service offered in these markets; tourist markets generally have higher load factors and larger equipment sizes. However, in the dense medium-haul markets, load factors and equipment size are actually larger in the nontourist markets. Yet, relative to the DPFI formula, fares are slightly lower in the tourist markets of this distance and density classification.

Differences in load factors and equipment size apparently do not completely explain the lower fares in tourist markets. The excess supply of aircraft, coupled with the relative ease with which carriers can enter tourist markets, are also factors. A carrier can attract business in a tourist market with few flights at less popular times if its fare is low enough. Consequently, carriers have a tendency to enter vacation markets to increase equipment utilization. Also, destination competition is more important in tourist markets than in other types of markets. Relative air fares may change a leisure passenger's decision of whether to vacation in Florida or in Hawaii.

Conclusion

The relaxation and then the removal of government regulation of fares have resulted in important changes in carrier pricing. Differences in fares among markets are related to differences in the costs of service. Moreover, carriers are increasingly relying on peak-load pricing. In a competitive environment, carriers have less incentive to engage in non-productive schedule rivalry; hence load factors have risen. This rise in load factor is important in

explaining why average fares have risen less rapidly than average costs.

Although fare differences among markets tend to be related to cost differences, at any time there are many markets where this is not so. In some markets carriers may be able to price above their costs for some period of time due to competitive conditions. In addition, carrier rivalry may lead to extraordinarily low prices in certain markets. Nevertheless, it appears that deregulation is producing a more sensible price structure than what existed before. Average fares have increased less than operating costs and carriers have taken steps to increase productivity in order to be competitive. This indicates that average fares are lower in a deregulated environment than what would have prevailed had regulation continued.

Senator HARKIN. Do you have anything else, Mr. Coleman, that you want to add or anything like that? I want to thank everyone, Mr. Fort, Mr. Coleman, thank you both for coming here, and I want to thank all of the witnesses, some who came a great distance. We've heard some excellent testimony.

This Small Business Committee under the leadership of Senator Bumpers from Arkansas and Senator Weicker from Connecticut will continue this process of looking into the antitrust/anticompetitive aspects of deregulation and how we are proceeding with deregulation of the airlines and with the proposal to let the Essential Air Service lapse next year. I've just heard too much, not only from my own constituents in Iowa, but from Senator Levin in Michigan, Senator Bumpers and others, that they are having problems in their States like we are, to not continue our review of these problems.

And it is something that we are just simply going to have to address. There is a public policy involved here that goes beyond the right of airlines to take this service away from communities and leave them hanging, or to mess up times and permit only certain schedules to operate that are not conducive to the operation of businesses in those communities.

We are undergoing some tremendous changes in the Midwest. We have to diversify our economy. We are undergoing that diversification, which means that we have to expand our different types of business entities outside of agriculture. If we can't get that air service in and out, then this part of the Country may just continue to decline in relation to other parts.

And so we want to see what we can do within the realm of deregulation. I don't think anyone wants to go back to the old firm regulation of everything in the airlines. Nor do we want to go to the unrestricted laissez faire market approach of just letting the airlines continue to merge and acquire and merge and acquire, having contracts that might be prohibitive, or anticompetitive of other airlines coming in, and then to just say, well, we own these slots, we can take them away from cities like Waterloo and Dubuque, pass them on to other cities.

I just don't think we want to go down that road, because, even though, as I said in my remarks, we want the airlines to make a profit, we want them to compete. But we don't want to just say, "Well, we can make a small profit serving Waterloo and Dubuque, but we can make a bigger profit some place else, so we will take it out and we will take the slots with us so no other airline can come in and make a profit doing that." So there still is a strong public policy aspect of this that tracks along with the profit-making motives of the major airlines.

I just want to reiterate that I'm very concerned that we find—if not monopolistic, at least oligopolistic-type-practices now looming on the horizon with the airlines. And that concerns me and I think it concerns all of the business people in the Midwest who want to be able to compete.

So having said that, again, I thank you for coming. I can't say right now if any legislation will be developed out of this hearing. Perhaps there will be. I don't know. We do know that we have the bills on continuing the Essential Air Service beyond next year.

Aside from that, I serve on the Appropriations Committee also, and we will be looking at what you have proposed in terms of the appropriations and make sure the appropriations meet the need.

So again, thank you all for coming and the Subcommittee will stand adjourned. The record will remain open for a reasonable length of time. Let's just say 15 days for any additional comments.

[Whereupon, at 1:05 p.m., the hearing was adjourned.]

APPENDIX

DALE BUMPERS, ARKANSAS, CHAIRMAN
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United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, DC 20510-6350

May 22, 1987

Mr. William R. Nesbit
P.O. Box 246
Park Ridge, IL 60068

Dear Mr. Nesbit:

On Monday, June 1, 1987, the Competition and Antitrust Enforcement Subcommittee of the Senate Committee on Small Business, of which Senator Tom Harkin is Chairman, will hold a hearing on the effect of airline deregulation on airline service to small and medium-size communities and small businesses. He and I appreciate your discussing the airline deregulation issue with our staff, and we look forward to including in the hearing record your views on the future of airline service to small communities.

Specifically, we would like you to address the following questions: 1) In light of the fact that the rapid growth of the air travel market plus the development of airline "hubs" at certain airports is placing a strain on the capacity of our present airport system, how should the system be expanded to handle this development? Should more airports be built, or should present airports be expanded or modified to serve both large and small carriers? 2) Does the slot system, which controls the number of landing slots at the four slot-controlled airports, place small and medium-sized communities in danger of losing air service as the airline market grows? Does the fact that the majority of the slots are owned by the major airlines and are often sold to the highest bidder rather than to the airline most in need have a detrimental effect on the ability of small airlines to remain in the marketplace, and does it threaten service to small communities? Does it effect the entry of new airlines into the market?

Any statistical information you can provide to the Subcommittee in responding to these questions would be most helpful. Your complete answers and any additional material will be included in the hearing record in their entirety.

Thank you for offering to provide the Subcommittee with information pertaining to the airline deregulation issue. If you have any questions concerning the hearing, please don't hesitate to contact Patty Barker of the Committee staff at (202) 224-8495.

Sincerely,

Dale Bumpers

DB/pbr

DANIEL MORTON & COMPANY, INC.
620 ELMORE
PARK RIDGE, ILLINOIS 60068

312 698-9662

May 28, 1987

The Honorable Dale Bumpers
Chairman, Committee on Small Business
United States Senate
Washington,DC 20510-6350

Dear Sir,

Thank you for the opportunity to respond to the questions of the Competition and Antitrust Enforcement Subcommittee on the effect of airline deregulation on airline service to small and medium-size communities and small businesses. I believe that recent publicity concerning the quality of airline service, safety, and the alleged shortage of airport capacity has overstated the severity of the alleged crisis in the interest of encouraging the Congress to open the Federal purse strings a little wider in the process of re-authorizing the Airport and Airway program -the Trust Fund, user fees, the Airport Improvement Program and the National Airspace System Plan. I have no quarrel with this objective as it is clearly in the national interest to expand the system's capacity. Furthermore, users of the system have shown a willingness to pay for the program so that a larger program will not increase the federal budget deficit. My answers to the Subcommittee's specific questions should be considered in the context of my views on the broader subject of the total impact of deregulation and appropriate ways to respond to the current situation.

The first question concerns the impact of deregulation on the capacity of the airport system. The gradual relaxation and eventual elimination of controls on airline routes and fares had the effect of broadening the market for air travel and stimulating the amount of air travel by permitting carriers more freedom in pricing, allowing the entry of new, low cost airlines, and encouraging competition which had the impact of significantly reducing airline fares <u>on average</u>. The efficiency of the air transportation system was improved in two important ways: 1)airline route systems were rationalized and 2)internal cross-subsidization was largely eliminated. Under regulation, individual airline route systems were created by the CAB on a case-by-case basis with the result that each system was a crazy quilt with no rational relationship among the various routes. For political reasons, airlines rarely asked to be removed from a route sector for fear of offending political forces which might be detrimental in obtaining new, desirable routes. The CAB layered on more competition on high density routes than could be sustained in the marketplace with the result that route sectors such as Chicago-Los Angeles were over-served and under-profitable.

Rationalization of the carrier route systems has been manifested in two primary ways -1) the development of "hub and spoke" schedule patterns and, 2) consolidation of the industry by a number of mergers and partial mergers. In the hot competitive battle brought on by deregulation, there were some casualties. It is alleged by some that the development of "mega-carriers" and "mega-hubs" has aggravated the shortage of capacity in the system. I doubt it. A hub and spoke system is a rational way to maximize the utilization of scarce resources, placing appropriate size airplanes on each spoke route and combining passengers from many origin points to each destination so that the largest possible airplane can be used. It is clear that the average daily utilization rate of airplanes (hours in use per day) and the average passenger load factor (percent of seats occupied) has risen significantly in recent years. These two measures of big efficiency improvements tell me that the hub and spoke systems are helping solve the capacity problem, not making it worse.

As for the mega airline impact, without respect to what one may think about the anti-trust implications, I think it is clear that reducing the number of competing carriers can only reduce the possibility of overloading the system at critical times of day. The hubs which are dominated by a single carrier such as Minneapolis and Pittsburgh can be a model of efficiency due to the absence of overlapping schedules. The worst delay problem at this time seems to be at Atlanta where two mega-carriers have many overlaps. In summary, I think it is an erroneous simplification to blame the alleged capacity shortage and resulting delay problems on hub and spoke scheduling and industry consolidation resulting from deregulation.

Service to small and medium communities was subsidized under regulation in two ways - first, by direct subsidy to "local service" airlines such as Ozark and, second, by the mandated formula for dividing revenue for a two carrier trip which favored the short haul carrier. For example, the revenue from a ticket for a trip from Waterloo to Washington via Chicago with a change of airlines in Chicago would be divided between the two airlines to give a disproportionate share to the Waterloo-Chicago carrier. Deregulation effectively ended these two sorts of subsidy and instituted the Essential Air Service concept which provides the subsidy more directly to the small community rather than to the carrier serving the community. Any airline willing to provide the service was eligible to receive the EAS subsidy, not just the designated Local Service carriers. So, for example, United Airlines, which had been obliged to continue to serve the tiny towns of Elko and Ely, Nevada for many years at a loss, actually went back on the subsidy roll for a while until it could locate an airline willing to take over the route. I believe it is clear that this new system is clearly a more rational way of doing business. The EAS system will expire in 1988 unless it is extended. In my view, it would be a serious error to abandon a system which has given the desired results at a very modest cost.

But if we are to continue to provide quality air service to small and medium size communities, we also need to have enough capacity in the system to handle them as well as the large metro areas. Growth of total air travel demand requires growth on the supply side as well.

With respect to how the system should be expanded to alleviate the present strains, I have the following suggestions:

1. Speed up the implementation of the National Airspace System Plan (NASP) and Airport Improvement Program (AIP) by authorizing the full utilization of the unobligated balance in the Airport/Airway Trust Fund. Surely the ingenuity of the Congress will be able to find a way to avoid the limits of the Graham-Rudman- Hollings Act to achieve this end.
2. Expand the capacity of existing major airports by building new runways, taxiways, terminals, and landing aids. New operating procedures proposed by FAA offer the promise of safely increasing utilization of existing capacity. Local opposition to airport expansion is a major obstacle to be overcome.
3. Shift general aviation activity away from major air carrier airports to the maximum extent possible by encouraging the retention, expansion and improvement of reliever airports in major metropolitan areas.
4. Support development and expansion of high speed ground transportation systems for high density, short haul market corridors to shift travelers out of airplanes. Consider a multi-modal financing scheme to expedite this process which is a long run solution in certain regions.
5. Provide better investment incentives for airlines to acquire new technology, efficient, <u>quiet, large capacity</u> airplanes to replace the vast majority of smaller, noisy airplanes now in use. Doubling the size of the average airplane will double the capacity of the airport system without any major change in system runway or airway capacity! Simultaneously, the average cost per passenger carried will be reduced through economies of scale.
6. Feeder traffic on spoke routes from small and medium size communities to the large hubs can best be handled in the long run by the development of airplanes and landing aids which can use short runways within the borders of existing airports which do not interfere with the main runway system. The key to meeting the air transport needs of these communities is insuring access to the big hubs by means of appropriate technology.

These steps will take time, money and political will and skill. The time problem can best be handled by implementing some short term strategies described below. Money seems to be no major problem since the users of the system seem quite willing to pay for it. Political will and skill may be the biggest hurdle. The key ingredient to designing a program to expand the airport system which can be sold to the general public - which contains some very reluctant, noise-sensitive airport neighbors - is to

announce and enforce strict new noise and environment rules which will speed the replacement or refurbishment of the present fleet. We now have jets which are very significantly quieter than the old models so the public is correct in insisting that the problem can and should be greatly alleviated.

I am encouraged that a number of short term actions can be effective in expanding the system's capacity to alleviate the current situation and buy enough time so that the long term actions described above can be implemented. The FAA is cautiously moving ahead on new procedures which will increase the utilization of the system by decreasing aircraft separation and adding new highways in the sky. There are signs of success on the East Coast which can be repeated elsewhere. Expanding and upgrading the skill level of the air traffic controller workforce possibly can be accelerated. If airlines are required to report to the public on the quality of their service in terms of on time performance and percent of flights completed, the effect will be to induce realistic scheduling practices. I see no great danger of harm to consumers if airlines are allowed to get together in a public forum under the watchful eye of DOT to adjust schedule timing so as to eliminate excess congestion at problem airports. Keep in mind that the airlines individually and collectively have a great interest in improving the quality of service. If airlines begin to compete with each other on the basis of service quality, all airline consumers will clearly benefit.

This brings us to the question of the slot control system at four airports (and potentially at others). This system clearly has the potential of adversely affecting the quality and quantity of service to small communities. It can inhibit the entry of new competition and the growth of small airlines. If slots are not pre-allocated to various user categories and are merely sold to the high bidder, small markets and airlines will lose out. In actual practice, it is not clear that these bad things have happened. The deregulated market has offset some of the potential harm of slot controls. In Chicago, Midway airport has been revived by a new entrant airline and now is attracting other airlines offering alternative service to O'Hare. In the New York area, Newark airport has expanded rapidly as well as Islip and White Plains. In the Washington area, Dulles is now thriving after years as a white elephant and Baltimore-Washington International is now a healthy hub offering an alternative to National airport. But there is no denying the potential for harm and I think it would be a serious mistake to bring more airports under the so-called high density rule. What should be done, in my opinion, is to require FAA to undertake a study of the consequences of eliminating the high density rule altogether. If a free market resolution of the problem is possible at Los Angeles, Atlanta, Denver and other busy airports, why not at O'Hare, LaGuardia, Kennedy and National? Slot controls should be a last resort. I believe a fair study would show that they are

not justified at this time.

One final word on the subject of the recent publicity in favor of a national program to build 10 or more new airports. I have described above a long list of actions which will have the effect of greatly expanding the capacity of the existing airport system. If all these steps were to be taken, I do not believe a good case can be made for many more airports. In certain areas, new airports may be justified but I believe that local considerations should be paramount. There does not have to be a nationwide airport capacity crisis and a huge new national program to subsidize new airport construction is premature. Let's do first things first.

Thank you again for the chance to convey my views to the Subcommittee.

Sincerely,

William R. Nesbit

William R. Nesbit
Vice President